

2009 Financial Performance of Owners of Unregulated Generation

**High Profits Earned in Restructured Wholesale Electricity Markets During
the Recession**

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I Introduction

This paper presents an updated analysis of the financial performance of a group of companies selling significant quantities of unregulated generation in the wholesale electricity market operated by the PJM Interconnection.¹ This analysis provides an important perspective on the question of whether consumers are benefitting from the restructured wholesale electricity markets operated by Regional Transmission Organizations (RTOs). Earnings by these companies indicate that their revenues from the sale of electricity greatly exceed their costs of producing electricity. Were these restructured markets truly competitive, as is claimed by their supporters, such high profits would bring additional entrants into the market and drive down the prices. Anomalous financial outcomes, such as those experienced by these companies year after year, would be unlikely to occur in efficient competitive markets. The continued profitability of these companies is therefore a direct indicator of insufficient competition and hence higher costs for consumers.

The primary findings of this study are:

- The primary owners of unregulated generation in PJM reported returns on equity about even with 2008 and significantly above regulated returns (with the exception of Constellation.)
- Three of the subsidiaries owning unregulated generation increased their profits between 2009 and 2008.
- Gross margins from the sale of electricity (revenue net of fuel and purchased power costs) increased in 2009 for three of the four companies reporting this measure.
- Shareholder gains for the companies in the study greatly exceeded returns from investments in the S&P 500 by almost \$40 billion over the past ten years.

This analysis is especially relevant for 2009 because there are conflicting reports of the performance of short-term wholesale electricity markets during the economic downturn. On one hand, the Federal Energy Regulatory Commission reports that wholesale electricity prices fell by 50 percent across the country², and the Compete Coalition and other market supporters identified

¹ Prior analyses were commissioned by APPA and prepared by Edward Bodmer. Mr. Bodmer also provided valuable input and assistance with this study. Past studies are: *The Electric Honeypot: The Profitability Of Deregulated Electric Generation Companies*, February 2007, <http://appanet.org/files/PDFs/Bodmerstudywappendices.pdf>; Affidavit of Edward Bodmer, Comments of the American Public Power Association, FERC Dockets RM07-19-000 19-000 and AD07-7-000, Wholesale Competition in Regions with Organized Electric Markets, September 14, 2007, <http://appanet.org/files/PDFs/bodmer.pdf>, and *The Deregulation Penalty: Losses for Consumers and Gains for Sellers*, Updated August 2009, <http://www.appanet.org/files/PDFs/BodmerUpdatedFinancialAnalysis81309.pdf>

² State of the Markets Report, 2009, Federal Energy Regulatory Commission, April 15, 2010, <http://www.ferc.gov/market-oversight/st-mkt-ovr/som-rpt-2009.pdf>

declining wholesale energy prices as evidence of the competitiveness of RTO markets.³ But the level of wholesale energy prices are only a part of the picture of the market outcomes – while wholesale energy prices fell, overall retail prices in both regulated and deregulated states slightly increased.⁴

Two general categories of factors are behind this wholesale/retail disparity. First there are additional impacts on retail rates outside of short-term wholesale prices. Many non-generation costs directly affect retail rates, such as local distribution costs. There is also likely to be a time lag between current wholesale price changes and the incorporation of such changes in contracts to serve retail load. Second, indices of wholesale energy prices by themselves do not provide a complete picture of all components of generation cost. Sources of wholesale market revenue to generators include capacity market, ancillary service, and uplift payments, as well as revenue from bilateral contracts, such as those arranged for provision of standard offer service. (Prices in these contracts frequently contain a “risk premium” on top of the wholesale energy price.)⁵

An example of the interplay of the various revenue streams paid to and the costs incurred by unregulated generation owners is provided in Allegheny Energy’s 2009 10-K statement.⁶ By looking only at the energy revenue from the PJM market, it would seem that the merchant generation segment suffered dramatic losses; energy market revenue declined by \$977 million from 2008 (51%). But when all sources of revenues and costs are considered, the picture is quite different. Allegheny’s capacity market revenue increased by \$161 million, revenue from hedges and power sold through contracts by \$577 million (partly due to a decline in the cost of purchased power to serve such contracts), and combined fuel, purchased power and transmission costs declined by \$122 million. In another example, First Energy notes that in the fourth quarter of 2009, “lower [First Energy Solutions] FES wholesale sales (\$61 million) were substantially offset by higher PJM Reliability Pricing Model (RPM) capacity revenues at Met-Ed & Penelec (\$44 million) and FES (\$16 million).”⁷

Because all of these various revenue streams are ultimately paid by consumers, an understanding of all revenues and costs is essential to determining how wholesale electricity markets are impacting end use prices. An examination of the profits of generation owners is one means of assessing the “bottom line” results of these multiple sources of revenue and costs in the wholesale electricity markets.

In spite of decreasing energy prices and the recession, some generation owners actually increased their profits in 2009 from the prior year. Examples of such increases are:

³ *RTO and ISO Markets are Essential to Meeting Our Nation’s Energy and Environmental Challenges*, Compete Coalition, <http://www.competecoalition.com/files/RTO-ISO-Benefits-White-Paper.pdf>, March 19, 2010, p. 1-2

⁴ *Retail Electric Rates in Deregulated and Regulated States: 2009 Update*, American Public Power Association March 2010, <http://www.appanet.org/files/PDFs/RKWfinal2009update.pdf>

⁵ Testimony of Kenneth Rose, Ph.D., Independent Consultant, before the Pennsylvania Public Utility Commission, Nov. 6, 2008, http://www.puc.state.pa.us/electric/pdf/EnBanc-WEM/Ttmy-Kenneth_Rose110608.pdf, p. 8 – 11.

⁶ Allegheny Energy, Inc., *2009 Form 10-K*, Merchant Generation Operating Revenues and Operating Expenses, p. 70-72, , <http://www.sec.gov/Archives/edgar/data/3673/000119312510044488/d10k.htm>

⁷ *First Energy Consolidated Report to the Financial Community, Fourth Quarter 2009*, February 11, 2010, <http://phx.corporate-ir.net/External.File?item=UGFyZW50SUQ9MzE1MDV8Q2hpbGRJRjRD0tMXxUeXBIPtM=&t=1>

- PSEG Power operating earnings of \$1,205 million in 2009 (\$2.38 per share) represented “a record year for Power” and an increase of \$35 million from 2008.⁸
- PPL’s supply segment earnings from ongoing operations increased from \$303 million to \$333 million.⁹
- First Energy’s net income from competitive energy services increased from \$472 to \$517 million between 2008 and 2009.¹⁰

An often made claim is that under deregulation, these profits are justified because it is the companies who bear the risks of excess costs, while consumers are freed from such risks. But the persistence of these high earnings and stockholder prices raises the question of whether companies are in fact bearing such risk.

A recent Constellation Energy financial presentation provides insight into the generator-owner perspective on the question of risk.¹¹ In a slide discussing the components of retail and wholesale prices, the company demonstrates the multiple cushions built into its prices – all of which are passed on to the customer. First, the presentation states that “the majority of the price is made up of costs that we know, that we can directly hedge, and that we can pass on to our customer.” In addition to these basic costs are “what we might call risk management costs, and we price these actuarially, based on our 12, 13 years of historical data. And, they’re also passed on to the customer.” The next component is the margin needed to cover cost of capital and other costs, and then on top of all this is an additional \$0.50 to \$1.00 of “added value.”

What is clear from these data is the need for a much more comprehensive assessment beyond a simple reporting of spot energy prices and broad unsupported statements about the benefits of “competition”. This report is far from the full assessment that is needed, but at a minimum demonstrates that the question of whether the RTO-operated markets are providing benefits to consumers in terms of just and reasonable rates has not been answered.¹²

⁸ PSEG Announces 2009 Results, PSEG Investor News, February 18, 2010, <http://phx.corporate-ir.net/External.File?item=UGFyZW50SUQ9MzIxODV8Q2hpbGRJRD0tMXxUeXBIPtM=&t=1>

⁹ 2009 Condensed Consolidated Financial Information, PPL Corporation and Subsidiaries, http://www.pplweb.com/NR/rdonlyres/D099556D-E40F-49EB-A076-5CD6D1B83B88/0/CondensedConsolidated_4Q09.pdf

¹⁰ First Energy Consolidated Report to the Financial Community, Fourth Quarter 2009, February 11, 2010, <http://phx.corporate-ir.net/External.File?item=UGFyZW50SUQ9MzE1MDV8Q2hpbGRJRD0tMXxUeXBIPtM=&t=1>

¹¹ Constellation Energy, 2010 Analyst Meeting, March 29, 2010, page 28, <http://files.shareholder.com/downloads/CEG/856857894x0x361842/bac2dd64-1bfa-43e1-8b92-b0f1c1b66976/CEG-Mar29-2010-Analyst-Day-PresentationSupportingMaterials.pdf>

¹² The General Accounting Office (GAO) concluded that “FERC has not conducted an empirical analysis of whether RTOs achieved the benefits expected of them or developed a comprehensive set of publicly available, standardized measures to help evaluate such performance,” and requested that FERC develop standardized measures that track the performance of RTO operations and markets. *Electricity Restructuring—FERC Could Take Additional Steps to Analyze Regional Transmission Organizations’ Benefits and Performance*, Report No. GAO-08-987, September 2008, <http://www.gao.gov/new.items/d08987.pdf>

The remainder of this report analyzes a few basic measures of financial performance:

- Return on Equity: Net income (after preferred dividends) divided by the average common equity balance. Net income is the profit of the company and the common equity is the amount under shareholder ownership.
- Gross Margin: Total revenue from the sale of electricity, less the cost of fuel and purchased power.
- Holding Period Returns to Shareholders: This is the primary measure of investor earnings, and is equal to the total cumulative earnings from changes in the share price over a given period of time (“holding period.”)

In addition to presentations of these measures, various quotes and statements from the company’s financial reports and presentations are provided, as these provide additional insight into the benefits to the generation owners and costs to consumers, and the companies’ own views of their performance.

The companies selected for this study are the same as those used in prior reports, with the addition of FirstEnergy, and include Exelon Corporation, Allegheny Energy, Public Service Enterprise Group (PSEG), Constellation Energy and PPL Corporation. Generating assets owned by these entities were generally constructed pursuant to state regulatory approvals, and original funding of the plants was made possible by rate-of-return regulation. FirstEnergy owns generation plants that sell power to both wholesale and retail customers in PJM and MISO. The company plans to integrate all of its assets into PJM by June, 2011.

The remainder of this paper explains the financial performance measures and the calculation of the outcomes in greater detail.

II Return on Equity

Table 1 below provides the 2008 and 2009 returns on equity (ROE) as calculated by the operating net income and common equity data provided in the 10-K filings with the Securities and Exchange Commission. Where available, returns are also presented for the company’s generation-owning subsidiary. All of the data used to calculate the ROE is provided in the Appendix.

As a check on the accuracy of the data, the ROE provided in company reports issued by the Value Line Investment Survey is also presented in the table.¹³ As shown, with the exception of Constellation, the Value Line ROEs are in line with those calculated from the 10-K reports. The ROE for PPL differs because while Value Line reports the total ROE, the ROE in the table,

¹³ www.valueline.com. Subscription required.

which was reported directly by PPL, excludes special items and reflects only ongoing operations.¹⁴

With the exception of Constellation, all of the companies in this study reported ROEs similar to those earned in 2008. These ROEs continue to be significantly above what would be earned under regulation. An often cited defense of the high profits of the generation owners is that profits can be reinvested in infrastructure investments. But the return on equity measure accounts for such investments. Greater investment levels would increase the depreciation and amortization of the physical plant, reducing net income, which would lower the return on equity. Also, the greater asset base book value would increase the liabilities on the balance sheet, including the common equity that is the denominator of the equation.

Estimating the actual return on equity for Constellation is difficult because of the sale in November 2009 of a 49.99% membership interest in Constellation Energy Nuclear Group LLC (CENG) to EDF Group. The after tax gain from the sale was about \$4.5 billion, which increased both the net income and the common equity through an increase in retained earnings. In addition, Constellation also incurred after-tax losses of \$372 million from sale of international commodities, gas and other trading operations. These were removed from both the net income and equity to obtain an adjusted return, as explained in greater detail in the Appendix. While a rough estimate, this adjusted ROE for Constellation provides better understanding of Constellation's return from continuing operations.

¹⁴ *PPL Corporation Reports Strong Fourth-Quarter Results and Exceeds 2009 Earnings*, News Release, February 5, 2010, <http://www.pplweb.com/newsroom/newsroom+quick+links/archived+news/2010/February/PPL+Corporation+reports+fourth-quarter+and+2009+earnings+results+020510.htm>

Table 1: Return on Equity

	2009	2008	2009	2008
	Calculated from 10-K		Value Line	
Exelon Corporation	21.4%	24.6%	22.5%	24.6%
Exelon Generation	31.3%	34.4%		
PPL Corp	13.6%	14.5%	8.1%	18.2%
PPL Energy Supply ¹	13.2%	12.4%		
PSEG Corp	18.1%	15.4%	18.0%	19.0%
PSEG Power	26.6%	25.8%		
Constellation	51.1%	(41.3)%	3.0%	2.7%
Adjusted Constellation ²	8.2%			
Allegheny	12.6%	13.9%	12.6%	13.9%
First Energy Corp	11.8%	16.1%	11.9%	16.2%
FE Solutions	16.4%	17.2%		
Weighted Average³ (without Constellation)				
Holding Company	16.7%	18.2%		
Generation Subsidiary	22.9%	24.1%		
Regulated Sample		8.8%		

¹ PPL Supply includes some international and gas trading operations.

² Adjusted Constellation is a best estimate of the return without the earnings from the sale of the nuclear facilities, as discussed below.

³ Average was weighted by common equity, and does not include Constellation.

In the analysis of these companies released last year, financial analyst Edward Bodmer estimated the costs to consumers from deregulation based on the difference in the ROE for the subsidiary owning unregulated generation with the average ROE for a sample of companies whose primary business is regulated utility operations. (See Appendix for a list of the regulated sample.) This “surplus return” or the excess that the generators are earning compared to what they would have earned under regulation, was calculated using the formula:

Surplus Return = (Generating Segment Adjusted ROE – Regulated ROE) x Deregulated Company Equity

The return on equity in this formula is calculated using after-tax net income. The next step is to determine the pre-tax amount by dividing the surplus return by one minus the tax rate of 40%.

The excess revenue for the unregulated generation subsidiaries, shown in Table 2, represents an estimate of the cost to consumers who bear the cost of the higher revenues. Table 2 shows the calculation of these excess costs for just the four generating segments with disaggregated financial data: Exelon Generation, PSEG Power, PPL Supply, and First Energy Solutions. The 2008 average regulated company ROE was used because this has been between 8 and 8.8 percent

for the past five years, and the 8.8 percent from last year would therefore be a conservative estimate. Another means to estimate a comparable regulated return would be to calculate the average return for the regulated segments of the companies in the study. For 2009, this was 7.6 percent, demonstrating that the 8.8 percent is not too high a number. The calculation of the regulated return is provided in the Appendix.

As shown below, estimated excess costs to consumers total \$3.8 billion from just these four companies in 2009.

Table 2: Costs to Consumers from Excess Generator Earnings
(Dollars in Millions)

Regulated ROE	8.8%
Average Generation ROE	22.9%
Excess ROE	14.1%
Total Equity	\$19,340
Excess Earnings (Excess ROE x Equity)	\$2,720
Tax Rate	40%
Total Excess Revenues/Costs to Consumers	\$3,808

III Gross Margins

This section presents the gross margin on electricity sales, which is the revenue net of fuel and purchased power costs, and is an indicator of the profitability of electricity sales. While margins are necessary, for example, to provide for a return on capital and other costs, increasing margins during a time of decreasing costs and prices indicate non-competitive market outcomes.

Not all companies report the margin and not all do so in the same manner. Data that are available are reported below. These data show that the margins on electricity sales remained about the same or increased in the past two years, impeding the transfer of the decreased costs to consumers.

Exelon: The total revenue earned per megawatt-hour (mwh) of electricity fell this year, but this decline was attributable solely to the drop in costs and not profits as indicated by the fact that the margin remained flat from 2008 to 2009.¹⁵

	Average Margin (per mwh)	Average Costs	Average Revenue
2009	\$38.20	\$16.39	\$54.59
2008	\$38.48	\$19.87	\$58.35
2007	\$35.16	\$19.54	\$54.70

Note: Margins include both wholesale and retail sales.

¹⁵ Data is from Exelon Corporation, 2009 Form 10-K, p. 88,
<http://www.sec.gov/Archives/edgar/data/22606/000119312510023280/d10k.htm>

PPL: PPL does not report the per mwh margins, and instead reports the following totals.¹⁶

	Margin	Expenses	Revenue
	(millions of dollars)		
2009	\$1,731	\$3,697	\$5,428
2008	\$1,564	\$2,705	\$4,269
2007	\$1,824	\$1,888	\$3,712

Despite the drop in fuel cost, PPL's supply costs increased in 2009, primarily due to higher purchased power costs. But the company was able to increase its margin above these costs.

An estimate of the margin per mwh can be obtained by dividing the aggregate amounts above by the total domestic retail and wholesale electricity supplied in each year¹⁷, resulting in the following:

	Average Margin	Average Costs	Average Revenue
	(per mwh)		
2009	\$22.22	\$47.46	\$69.68
2008	\$18.82	\$32.56	\$51.38
2007	\$24.79	\$25.66	\$50.44

PPL is also forecasting strong growth in energy margins in 2010 based on hedged power and fuel prices as well as capacity prices in PJM.¹⁸

PSEG: PSEG did not report margins, but stated that generation margins had increased in 2009 and accounted for 5 cents of the overall increase in the earnings per share.¹⁹

Constellation: Because of the difficulty in discerning the ROE for Constellation, the margins are a useful additional measure of the company's earnings. Constellation reported margins separately for merchant generation, which increased in 2009 to \$1,976 million from \$1,919 million in 2008 (a \$57 million increase), equal to \$37.70 and \$42.96 per mwh of wholesale generation in 2008 and 2009.²⁰ Constellation attributes a significant part of the increase in the margin to "[h]igher energy prices for the output of our generating assets in the PJM and New York regions based on prices established at the end of 2007."²¹

¹⁶ PPL Corporation, 2009 Form 10-K, "Gross Domestic Energy Margins,"

<http://www.sec.gov/Archives/edgar/data/317187/000092222410000012/form10k.htm>

¹⁷ PPL Corporation, 2009 Form 10-K, Item 6. Selected Financial and Operating Data,

<http://www.sec.gov/Archives/edgar/data/317187/000092222410000012/form10k.htm>

¹⁸ PPL Corporation reports strong fourth-quarter results and exceeds 2009 earnings forecasts, February 5, 2010,

<http://www.pplweb.com/newsroom/newsroom+quick+links/archived+news/2010/February/PPL+Corporation+reports+fourth-quarter+and+2009+earnings+results+020510.htm>

¹⁹ PSEG Announces 2009 Results, PSEG Investor News, February 18, 2010, Attachment 7: Year to Date EPS Reconciliation, <http://phx.corporate-ir.net/External.File?item=UGFyZW50SUQ9MzIxODV8Q2hpbGRJRD0tMXxUeXBIPtM=&t=1>

²⁰ Constellation Energy Corporation, 2009 Form 10-K, Merchant Energy Operating Statistics, p. 9, <http://www.sec.gov/Archives/edgar/data/9466/000104746910001515/a2196632z10-k.htm>. Per mwh data were obtained by dividing gross margin by mwh of generation.

²¹ Constellation Energy Corporation, 2009 Form 10-K, p. 47.

Allegheny and First Energy did not directly provide data on their margins.

IV Shareholder Returns

This section presents a measure of profitability from the perspective of investors in the company. The holding period return to investors measures the gains realized by investors from share price increases and dividend payments over the past 5 and 10 years. This return is compared to the amount that would have been realized had investments been made instead in the S&P 500. This type of analysis does not depend on accounting data. However, the method depends on the start date of the analysis and assumes that the markets efficiently measure future cash flow prospects for the companies.

As shown in Table 3 below, the total shareholder gain compared to the S&P 500 totaled \$38 billion over the past ten years. Over the past five years, the gains were lower, but still substantial -- \$5.9 billion.

Table 3: Gain to Shareholders of Unregulated Generation Owners Relative to S&P 500

10-Year Holding Period

	Adjusted Stock Price*		2010/2000 Price Ratio	# Shares** (millions)	Value of Stock in 2010 (millions)		Surplus/(Cost) (millions)
	3/31/10	3/31/00			Actual	at S&P Ratio	
Exelon	\$43.27	\$13.27	3.26	654	\$28,299	\$6,772	\$21,526
PPL	\$27.71	\$7.31	3.79	145	\$4,018	\$827	\$3,191
PSEG	\$29.52	\$14.81	1.99	232	\$6,849	\$2,681	\$4,167
Constellation	\$35.51	\$23.78	1.49	151	\$5,362	\$2,802	\$2,560
Allegheny	\$23.00	\$23.51	0.98	110	\$2,530	\$2,018	\$512
FirstEnergy	\$38.51	\$13.37	2.88	224	\$8,626	\$2,337	\$6,289
S&P 500	\$1,169.43	\$1,498.58	0.78			Total	\$38,245

*Stock Price is adjusted for splits and dividends. Source: <http://finance.yahoo.com/>

** Number of shares is that reported in each company's Form 10-K for 2000.

PSEG historical data was not available on Yahoo and was obtained from PSEG's web site at:

<http://phx.corporate-ir.net/phoenix.zhtml?c=99807&p=irol-stockLookup>

5-Year Holding Period

	Adjusted Stock Price*		2010/2005 Price Ratio	# Shares** (millions)	Value of Stock in 2010 (millions)		Surplus/(Cost) (millions)
	3/31/10	3/31/05			Actual	S&P Ratio	
Exelon	\$43.27	\$38.68	1.12	667	\$28,861	\$25,556	\$3,305
PPL	\$27.71	\$22.69	1.22	380	\$10,530	\$8,541	\$1,989
PSEG	\$29.52	\$27.20	1.09	240	\$7,085	\$6,466	\$619
Constellation	\$35.51	\$44.72	0.79	178	\$6,321	\$7,885	(\$1,564)
Allegheny	\$23.00	\$19.69	1.17	163	\$3,749	\$3,179	\$570
FirstEnergy	\$38.51	\$34.31	1.12	224	\$8,626	\$7,613	\$1,013
S&P 500	\$1,169.43	\$1,180.59	0.99			Total	\$5,932

*Stock Price is adjusted for splits and dividends. Source: <http://finance.yahoo.com/>

** Number of shares is that reported in each company's Form 10-K for 2005.

Exelon and PSEG both provided some additional data on comparative returns in recent presentations to financial analysts:

PSEG noted that its three, five, and 10 year total returns have exceeded the S&P 500 Electrics and the Dow Jones Utility Average. The three-year return for PSEG was about 12 percent, while the other two measures were negative over that time frame.²²

Exelon stated that \$100 invested in Exelon Corporation common stock on December 31, 2004 would be worth \$129.42 at the end of 2009, with dividends reinvested. The same investment in the S&P 500 would only be worth \$102.08.²³ FirstEnergy provides a chart showing \$100 worth of its stock purchased in 2004 appreciating to \$150 in 2009 while the S&P 500 remained flat in the same time period.²⁴

V Generation Owner Perspective on Restructuring and Deregulation

Were deregulation to be producing increased competition, this should logically create a sense of concern by generation owners regarding the potential rivalry from competitors. Instead statements made by the companies in this study indicate a direct financial benefit from deregulation. Moreover, despite the publicity given by RTOs and generators to the recent wholesale price drops, the generation owners express in their financial statements the belief that prices will increase.

Examples of each category of statements are provided below:

²² PSEG Presentation to the Financial Community, New York, NY, March 8, 2010, Slide 15, <http://phx.corporate-ir.net/External.File?item=UGFyZW50SUQ9MzUzNDJ8Q2hpbGRJRD0tMXxUeXBIPtM=&t=1>

²³ Exelon Corporation, 2009 Form 10-K, p.56, Comparison of Five-Year Cumulative Return.

²⁴ FirstEnergy, 2009 Form 10-K, p. 45, <http://www.sec.gov/Archives/edgar/data/20947/000103129610000011/form10k.htm>

On the link between profits and deregulation:

If market deregulation is reversed or discontinued, our business prospects and financial condition could be materially adversely affected. In some markets, state legislators, government agencies and other interested parties have made proposals to change the use of market-based pricing, re-regulate areas of these markets that have previously been deregulated or permit electricity delivery companies to construct or acquire generating facilities. The ISOs that oversee the transmission systems in certain wholesale electricity markets have from time to time been authorized to impose price limitations and other mechanisms to address volatility in the power markets. These types of price limitations and other mechanisms may reduce profits that our wholesale power marketing and trading business would have realized under competitive market conditions absent such limitations and mechanisms. (emphasis added)

-- PPL Corporation 2009 Form 10-K

If competitive restructuring of the electric or gas industries is reversed, discontinued, restricted, or delayed, our business prospects and financial results could be materially adversely affected.

-- Constellation Energy 2009 Form 10-K

[P]roposals to re-regulate our industry may be made, and legislative or other action affecting the electric power restructuring process may cause the process to be delayed, discontinued or reversed in the states in which we currently, or may in the future, operate. Such delays, discontinuations or reversals of electricity market restructuring in the markets in which we operate could have an adverse impact on our results of operations and financial condition.

-- First Energy 2009 Form 10-K

On future price increases:

The expiration of the PPA with PECO at the end of 2010 will likely result in increases in margins earned by Generation beginning in 2011 for the portion of Generation's electricity portfolio sold to PECO under the PPA...Exelon expects modest upside in the upcoming RPM auction.

-- Exelon Corporation 2009 Form 10-K

With the expiration of the long-term power purchase agreements between PPL Electric and PPL EnergyPlus, PPL EnergyPlus now has multiple options as to how, and to whom, it sells the electricity produced by PPL Energy Supply's generation plants. These sales are based on prevailing market rates, as compared to pre-determined capped rates under the expired supply agreements with PPL Electric...Overall, these changes and the resulting level of hedged electricity prices are expected to have a positive impact on the financial condition, operating results and cash flows of PPL Energy Supply.

-- PPL Corporation 2009 Form 10-K

In other words, these entities do not fear loss of market position or revenue loss from competition in electricity markets as they are currently structured, rather they fear that these

markets may be restructured by regulators to eliminate or reduce current profit opportunities. This alone should raise the question of whether these markets facilitate actual “competition.”

VI Conclusion

APPA has for many years advocated for greater data transparency in the wholesale electricity markets and for comprehensive investigations by the Federal Energy Regulatory Commissions about whether these markets are producing just and reasonable rates. These financial analyses are one step in beginning to fill in the gap. But while the data presented here and in past financial analyses cast doubt on whether the RTO-operated markets are in fact benefitting consumers and producing just and reasonable rates, they also demonstrate the need for a comprehensive effort to investigate the performance of these markets.

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Appendices

A. Data Used for Return on Equity (ROE)

The calculations were all based on the following formula using data obtained from 2009 10-K reports filed with the Securities and Exchange Commission, unless otherwise noted.

$$\text{Return on Equity} = \frac{\text{Net income from Continuing Operations}}{\text{Common Equity}}$$

Net income from Continuing Operations is the profit of the company earned from regular ongoing activities. Common equity is the amount of the company's assets under shareholder ownership not including preferred shareholders. These data and their sources are provided in the tables below.

Exelon

	<u>Exelon Corporation</u>		<u>Generation</u>	
	<u>Net Income</u>	<u>Equity</u>	<u>Net Income</u>	<u>Equity</u>
	(dollars in millions)			
2009	\$2,706	\$12,640	\$2,122	\$6,790
2008	\$2,717	\$11,047	\$2,258	\$6,565

Source: Exelon Corporation, 2009 Form10-K, February 5, 2010, Item 6. Selected Financial Data, http://www.sec.gov/Archives/edgar/data/22606/000119312510023280/d10k.htm#toc43546_31

PPL

The ROE for the entire corporation were not calculated and were instead reported by PPL, *Condensed Consolidated Financial Information*, PPL Corporation and Subsidiaries, http://www.pplweb.com/NR/rdonlyres/D099556D-E40F-49EB-A076-5CD6D1B83B88/0/CondensedConsolidated_4Q09.pdf

PPL Energy Supply

	<u>Net Income</u>	<u>Equity</u>
	(dollars in millions)	
2009	\$605	\$4,568
2008	\$594	\$4,794

Net income was calculated by subtracting PA Delivery from total Earnings from Ongoing Operations. Source: *Condensed Consolidated Financial Information*, PPL Corporation and Subsidiaries, Reconciliation of Business Segment Earnings from Ongoing Operations to Reported Earnings.

Common equity is from PPL Corporation, 2009 Form 10-K, Consolidated Balance Sheets, PPL Energy Supply, LLC and Subsidiaries.

PSEG

	<u>PSEG Inc.</u>		<u>PSEG Power</u>	
	<u>Net Income</u>	<u>Equity</u>	<u>Net Income</u>	<u>Equity</u>
	<u>(dollars in millions)</u>			
2009	\$1,592	\$8,788	\$1,189	\$4,467
2008	\$1,188	\$7,711	\$1,115	\$4,322

Public Service Enterprise Group, Inc., 2009 Form 10-K, Public Service Enterprise Group, Inc., Consolidated Statements of Operations and Consolidated Balance Sheets, and PSEG Power, LLC, Consolidated Statements of Operations and Consolidated Balance Sheets, http://www.sec.gov/Archives/edgar/data/81033/000119312510040508/d10k.htm#rom76948_27

Constellation Energy

Adjustments to Return on Equity for Sale of Nuclear Facilities and other Operations

Source in 2009 10-K

Adjustments to Net Income

Constellation Energy Net Income	\$4,443	Item 6. Selected Financial Data
After Tax Gain from Sale of CENG	(\$4,456)	Merchant Energy Business Results Table
Amortization of Basis Difference	\$18	"
Losses from sale of international commodities, gas and other trading	\$372	"
<u>Revised Net Income</u>	<u>\$377</u>	

Adjustments to Common Equity

Common Equity	\$8,697.1	Consolidated Balance Sheets
Total Adjustment to Net Income	(\$4,066)	
Other CENG impacts on Equity	(\$35)	Consolidated Statements of Common Shareholders' Equity & Comprehensive Income
<u>Revised Common Equity</u>	<u>\$4,596</u>	
<u>Adjusted Return on Equity</u>	<u>8.2%</u>	

Allegheny

	<u>Net Income</u>	<u>Equity</u>
	<u>(dollars in millions)</u>	
	2009	\$393
2008	\$395	\$2,850

Source: Allegheny Energy Inc., 2009 Form 10-K, Consolidated Statements of Income, p. 99, and Consolidated Balance Sheets, p. 103, http://www.sec.gov/Archives/edgar/data/3673/000119312510044488/d10k.htm#rom60215_22

First Energy

	<u>First Energy Corp</u>		<u>First Energy Solutions</u>	
	<u>Net Income</u>	<u>Equity</u>	<u>Net Income</u>	<u>Equity</u>
	(dollars in millions)			
2009	\$1,006	\$8,557	\$577	\$3,515
2008	\$1,342	\$8,315	\$506	\$2,944

Source: First Energy 2009 Form 10-K, Summary of Results of Operations, FirstEnergy Solutions, Condensed Consolidated Statements of Income and Balance Sheets, <http://www.sec.gov/Archives/edgar/data/20947/000103129610000011/form10k.htm>

B. Calculation of Regulated Return on Equity

The regulated sample was developed by reviewing Value Line reports for numerous regulated water, electric and natural gas utility companies that are located in states that have not restructured their electricity markets. Companies that receive a significant percentage of their income from unregulated subsidiaries and companies that have had unusual losses are excluded from the sample. After screening many companies, a sample of twenty-three regulated utility companies was identified. Below is a list of companies included in the regulated sample and their returns on equity²⁵. (The regulated sample was updated from the prior reports because various companies have merged and/or changed their business activities.)

Regulated Company ROE Reported by Value Line									
Company	Ticker	2001	2002	2003	2004	2005	2006	2007	2008
Atmos Energy	ATO	9.60%	10.40%	9.30%	7.60%	8.50%	9.60%	8.70%	8.80%
AGL Resources	AGL	12.30%	14.50%	14.00%	11.00%	12.90%	13.20%	12.70%	12.60%
Amreican States Water	AWR	10.10%	9.50%	5.60%	6.60%	8.50%	8.10%	9.30%	8.00%
Avista Corp	AVA	7.90%	4.50%	6.60%	4.80%	5.90%	8.20%	4.20%	8.00%
CH Enregy Group	CHG	9.80%	7.00%	9.00%	8.40%	8.60%	7.70%	8.00%	6.50%
CLECO Corporation	CNL	14.20%	12.80%	12.20%	11.80%	10.60%	8.30%	7.90%	9.00%
California Water	CWT	7.20%	9.40%	7.80%	8.90%	9.30%	6.80%	8.10%	10.00%
Cent Vermont P.S.	CV	6.00%	9.30%	8.00%	6.50%	0.60%	9.70%	7.90%	8.50%
DTE Energy Co.	DTE	7.20%	13.80%	9.10%	8.00%	10.00%	7.50%	7.70%	7.50%
Duke Energy	DUK						4.10%	7.20%	6.10%
Con Edison	ED	11.80%	11.10%	9.60%	7.70%	9.60%	9.10%	10.30%	12.00%
El Paso Electric	EE	14.60%	6.30%	6.30%	6.30%	6.60%	10.60%	11.20%	11.50%
Empire District	EDE	3.90%	7.80%	7.80%	5.80%	6.00%	8.50%	6.20%	7.50%
Hawaiian Electric	HE	11.40%	11.10%	10.70%	8.80%	9.60%	9.70%	7.10%	7.50%
IDACORP	IDA	13.30%	7.10%	4.40%	7.70%	6.20%	8.90%	6.80%	8.50%
Nisource	NI	6.80%	9.70%	9.30%	8.90%	6.00%	6.30%	6.10%	7.80%
Northeast Utilities	NU	6.20%	6.80%	5.10%	5.00%	4.30%	8.30%	9.40%	9.00%
NW National Gas	NWM	10.00%	8.90%	9.10%	8.90%	9.90%	10.90%	12.50%	11.00%
PEPCO Holdings	POM	11.00%	8.70%	7.90%	7.60%	7.60%	7.00%	7.40%	9.00%
SCANA Corp	SCG	10.00%	11.30%	11.80%	11.90%	11.60%	10.30%	10.60%	11.20%
UIL Holdings	UIL	11.90%	9.10%	6.00%	6.70%	5.80%	9.90%	10.10%	10.30%
Unisource Energy	UNS	14.30%	7.60%	8.40%	7.90%	7.50%	10.60%	8.50%	2.50%
XCEL Energy	XEL	12.50%	3.70%	9.70%	9.90%	9.10%	9.60%	9.00%	9.50%
Average		10.09%	9.11%	8.53%	8.03%	7.94%	8.82%	8.56%	8.80%
Median		10.05%	9.20%	8.70%	7.80%	8.50%	8.90%	8.10%	8.80%

As a check on this regulated ROE, the average ROE was calculated for the regulated subsidiaries of the companies in this study from the data in their 10-K reports.

Regulated Subsidiary	ROE
PECO	13.6%
ComEd	5.4%
PSEG	7.6%
Ohio Edison	11.9%
Toledo Edison	4.9%
Jersey Central Power & Light	6.6%
Metropolitan Edison	5.2%

²⁵ *The Deregulation Penalty: Losses for Consumers and Gains for Sellers*, Updated August 2009, <http://www.appanet.org/files/PDFs/BodmerUpdatedFinancialAnalysis81309.pdf>

Pennsylvania Electric	7.0%
PPL Electric Utilities	9.1%
Weighted Average	7.6%

Source of net income and common equity data used for regulated subsidiary ROEs:
Exelon Corporation, 2009 Form 10-K, Selected Financial Data, ComEd and PECO,
http://www.sec.gov/Archives/edgar/data/22606/000119312510023280/d10k.htm#toc43546_31

Public Service Enterprise Group, Inc., 2009 Form10-K, PSEG Co., Consolidated Statements of Operations and Consolidated Balance Sheet,
http://www.sec.gov/Archives/edgar/data/81033/000119312510040508/d10k.htm#rom76948_27

FirstEnergy 10-K, Consolidated Statements of Income and Consolidated Balance Sheets,
<http://www.sec.gov/Archives/edgar/data/20947/000103129610000011/form10k.htm>
(Note: Cleveland Electric was not included since its net income was negative.)

PPL Corporation, 2009 Form 10-K, Item 6. Selected Financial Data. ROE was reported by PPL and common equity was used for weighted average.
<http://www.sec.gov/Archives/edgar/data/317187/000092222410000012/form10k.htm>