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**UNITED STATES OF AMERICA  
FEDERAL ENERGY REGULATORY COMMISSION**

Credit and Capital Issues Affecting  
The Electric Power Industry

Docket No. AD09-2-000

**Statement of W. Paul Bowers  
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Introduction

My name is Paul Bowers, and I am Executive Vice President and Chief Financial Officer of Southern Company. I am here today testifying on behalf of the Edison Electric Institute and Southern Company. The Edison Electric Institute (EEI) is the association of U.S. Shareholder-Owned Electric Companies. Its members serve 95 percent of the ultimate customers in the shareholder-owned segment of the industry, and represent approximately 70 percent of the U.S. electric power industry. Southern Company is the owner of five electric operating companies that include Georgia Power, Alabama Power, Mississippi Power, Gulf Power in Florida and Southern Power. In our Southeastern region, we have more than 42,000 MW of generating capacity serving 4.4 million retail customers. Our franchised retail service territories cover 120,000 square miles and we have over 27,000 miles of transmission lines. Our wholesale competitive generation company, Southern Power Company, owns or controls 7,700 MW of generation capacity in the Southeast and serves wholesale customers primarily under long-term capacity contracts.

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This is a critical time for the electric utility industry as it confronts the challenge of meeting significant infrastructure and environmental investment requirements at a time when cost of capital has significantly increased due to the historic volatility and dislocation in the global capital markets and economy. Today I will address many of the key factors that created this challenge as well as potential solutions, including the necessity to develop and implement constructive regulatory policies. In doing so, I will primarily focus on the issues facing the broader industry, but will also reference Southern Company's experience.

The electric utility industry is the second most capital intensive sector in the country, surpassed only by railroads. Utilities have and must continue to invest billions of dollars to maintain reliability, replace aging infrastructure and meet load growth requirements. In addition, many utilities face substantial capital needs to comply with current or future environmental requirements, even before the unknown costs of potential climate change legislation and state or federal renewable portfolio requirements are taken into account. Our nation's energy policies are evolving, but it is increasingly clear we must expand the portfolio for generation by using a broad array of technologies such as nuclear power, clean coal and renewable resources. We must also improve the efficiency of producing electricity as well as increase the energy efficiency at the point of use to meet both future demand and environmental requirements. We also need to invest in enabling technologies for the smart grid, smart technologies and plug-in hybrid electric vehicles.

Capital expenditures for the 2008-2010 period are projected to be about \$230 billion, which factors in recent downward revisions by many companies for 2009 and 2010 (compiled by EEI). For the period of 2010 to 2030, estimates range from \$1.5 trillion to \$2.0 trillion dollars, net of projected savings from aggressive energy efficiency and demand response programs

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(Brattle Group for the Edison Foundation - See Exhibit 1). Southern Company alone expects to invest \$10.0 billion in 2009 and 2010. Notwithstanding dampened demand in some areas due to the current economic crisis, there are still significant needs for capital to support ongoing operations, which will further increase as the economy recovers.

As the industry enters this period of historic capital investment, it confronts two separate but inter-related challenges: first, the industry's credit and financial strength is substantially lower than when it last entered such a period in the 1980s; and second, the capital markets are in turmoil, with unprecedented volatility negatively impacting the availability, terms and cost of capital. The current credit crisis facing the electric utility industry has come about for many reasons, including the general state of the economy, contraction of lending by weakened financial firms, fewer financial firms to compete for the industry's financing needs and the increased risk that many electric industry participants face due to legislative and regulatory uncertainty.

Historically, utilities have had ready access to capital markets at reasonable rates. This is partly due to the high credit ratings of most utilities as well as the ability of utilities to generally increase rates to reflect increased costs. However, much has changed in recent years. As a whole, the average credit rating of the industry has dropped to "BBB". To illustrate this point, look at the credit ratings of utilities in 1970 versus 2007. In 1970, 97% of utilities were rated "A" or better while in contrast only 30% were rated this high in 2007. (S&P – see Exhibit 2) There are a variety of reasons for this decline in credit ratings including increased business risk and leverage. The decline in credit ratings combined with the current financial crisis affect the cost, terms and availability of capital which impacts companies' ability to invest.

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This decline in credit ratings has been compounded by the recent upheavals on Wall Street that have led to substantial increases in the risk premiums for debt and equity for all utilities, but especially for those without high quality credit ratings. As a result, the cost of debt capital for lower investment grade rated companies (BBB categories) is in many cases significantly higher than companies with stronger ratings (A categories). For example, in mid-2008 the credit spread over Treasuries for the average “BBB+” utility was around 50 basis points higher than for the average “A” utility, but this rose to around 100 basis points near the end of the year. The effect has been even more pronounced for “BBB-” and “BBB” utilities. This widening cost difference, even within investment grade ratings, illustrates the importance of maintaining high credit ratings in this capital intensive period for the industry. Some companies with lower credit ratings have not been able to access commercial paper and other short-term credit markets, further exacerbating the impact of the credit crunch. It is electricity consumers who ultimately pay the bill for these lower bond ratings and the resulting higher cost of capital.

In addition to this increased cost of debt, the availability and cost of credit from banks have been even more severely impacted due to their financial troubles. This is important since many lower rated utilities rely more on banks than the capital markets, especially for short-term financing. Very few new bank credit lines are being made available, and the maturities have been shortened from up to five years to almost exclusively less than one year. In addition, pricing for new credit lines has increased dramatically. Prior to the financial crisis, upfront fees on bank credit facilities were often below 10 basis points, but have now risen to 150 to 300 basis points. Equally troubling, banks are now seeking to link borrowing cost under these credit lines to the prices of credit derivatives instead of rates negotiated at the time the bank lines are executed. This type of index pricing shifts risk previously managed by banks’ underwriting

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practices to the borrowers and has the potential to create tremendous volatility of borrowing cost without effective ways of hedging that volatility.

Southern's experience is instructive concerning the absolute and relative importance of maintaining a strong credit profile to ensure ready access to capital markets at reasonable prices, particularly in the challenging economic environment we now confront. One of Southern Company's financial imperatives is to maintain an "A" credit rating. The benefit of this financial belief has shown its value as we weather the current financial crisis. We issued approximately \$500 million of new equity during 2008, while our share price has remained relatively stable during the unprecedented volatility in equity markets. Also, we have continued to access debt markets to meet our needs for new investment. Throughout 2008, we issued approximately \$3.6 billion of long-term debt at an average rate of 4.5%. Even as the financial crisis worsened in the fourth quarter, we issued \$1.0 billion of long-term debt with an average maturity of eight years at an average rate of 5.7% -- this is a significant increase in our cost of borrowing and it shows the impact of this crisis even on companies with strong credit ratings. In contrast, for several other utilities in the "BBB" category the situation has been worse since similar long-term debt has been issued at an average rate roughly 300 basis points higher.

These cost of capital challenges are exacerbated by the slowdown in demand growth in some areas of the country. While it has temporarily reduced the need for near-term capital expenditures, it has also raised revenue concerns in those regions most affected. A majority of a utility's non-fuel costs are fixed. With lower revenues (due to lower sales) that are not likely to be fully offset by lower costs, and in the absence of rate relief, some utilities could be placed in the position of having to cut equity dividends, which will also increase their cost of capital as stock prices are negatively impacted. Adding to this challenge, our industry is experiencing

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increases in delinquent or uncollectible accounts, as the slowing economy increasingly impacts our customers. The American economy needs the industry ready to serve as we emerge from the current economic downturn – we cannot stop investing and must be able to access credit on a cost efficient basis.

Faced with these daunting challenges, how do we strengthen the financial profile of our industry and regain the ability to access capital at reasonable costs?

The first part of the solution is outside the control of utilities, state regulators and the Commission. The global capital markets must regain their stability and the financial industry must resolve its problems in order to resume normal lending practices. The second part of the solution resides with the utilities themselves. Our industry has a responsibility to take specific measures to improve its ability to access the financial markets. The regaining and maintaining of strong credit ratings is absolutely essential. Whether for traditional vertically-integrated utilities, distribution utilities or generation companies operating in restructured markets, the answer to restoring credit ratings is the same: achieve stable, predictable and sufficient revenues (in restructured markets this means a competitively determined market price), earnings and cash flows. To do this, many utilities must take steps to shore up their balance sheets and liquidity positions. Cost containment in both O&M and capital must be a major focus to ensure efficient allocation and use of resources that does not negatively impact customer satisfaction and service. I believe almost every utility in the industry is undertaking cost reduction efforts to reduce the need for capital and to shore up cash flows.

The final part of the solution is the implementation of constructive regulatory policies that reflect the risks inherent in the current utility business environment. As noted above, some utilities are now unable to access commercial paper or other short-term credit markets. Access to

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these markets is crucial for supporting ongoing utility operations and maintaining corporate liquidity. It is unclear in the current financial environment whether traditional means of short-term funding of utility operations, such as commercial paper, will be available to any but the highest financially-rated companies. For this reason, regulators must be open to alternative ways of financing utility operations as well as capital expansion. Also, policies which improve the certainty of recovery for capital investments will improve credit quality and the ability to raise capital at reasonable rates. With respect to utilities in traditionally regulated markets, this means mechanisms for the review and establishment of recovery of prudently incurred investments before the capital expenditures are incurred. And regulators must act quickly to respond to the rapidly changing conditions in credit markets and the financial industry.

As I mentioned earlier, Southern Company has weathered the current crisis fairly well. Southern Company's relative success through this economic turmoil can be attributed to several factors, but I think one of the most important is the recognition by our regulators that keeping the utility financially healthy is beneficial to our customers. Our state public service commissions have recognized, by and large, the need to adjust rates in response to changing costs and the need to allow returns that truly reflect the risks of our business. For example, in Georgia we have a process where any new plant is certified before construction is allowed; once certified, the certified costs are recoverable if incurred prudently. In other jurisdictions, notably Iowa and Wisconsin, statutes have been established that fix the financial rate-making principles for the life of proposed plants. This type of consistent and constructive regulatory environment has allowed us to access new capital at rates lower than much of the industry. Lower cost of capital in turn results in lower cost of investment.

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For utilities in the restructured markets, the distribution functions are, in most cases, regulated based on cost of service so the above discussion still applies. Generation companies that expend their capital based on their own forecasts of needs and resulting revenue expectations require regulatory consistency as an important element of the investment decision. Changing the rules or undoing prior agreements will certainly increase the risk. Regulatory predictability and certainty are just as important in restructured markets as in traditionally regulated markets.

The Commission should be commended for using many different regulatory tools to help foster creditworthiness, including Construction Work in Progress, incentive returns for transmission, market based rates, and a demonstrated willingness to consider performance-based or other innovative rate practices, such as formula rates. However, the awarded return on equity for utilities has been declining in general and the industry average ROE is near historic lows at a time when the cost of capital is increasing and investment is needed more than ever. We urge the Commission to take a new look at the process for determining returns to ensure the methods appropriately reflect risk and market conditions. Utility investors are already realizing greater risk in their equity investments. In the fourth quarter of 2007, the volatility of the Dow Jones Utility Index averaged less than 17%, but in the fourth quarter of 2008, the volatility in that same index averaged 69%, indicative of more than four times the risk of just one year earlier.

Finally, we must maintain a constructive and transparent dialog with regulators at both the federal and state levels to keep them apprised of our capital investment plans. In the course of these dialogues, innovative solutions may come about that result in a positive outcome for customers and investors. Tools such as the recovery of pre-construction costs through CWIP and appropriate securitization that can help preserve financial viability at the most reasonable costs to consumers should be considered. But at the very least, regulators must understand the need for

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solvent, financially healthy utilities in these times when we must build new electricity infrastructure to enable future economic growth and prosperity.

Just as our industry is facing difficult circumstances, we understand the difficult circumstances facing many of our customers, and we must strive to help them through these difficult times while continuing to invest for the future, since our own well-being depends ultimately upon theirs. Southern Company has a program called Project Share, where we match contributions made by our customers to support other customers in need. Some other examples include bill assistance programs such as that offered by Arizona Public Service to provide a discount up to 40 % off the cost of electricity for customers that meet certain income guidelines. Utilities also provide community outreach programs such as that offered by Connecticut Light & Power to update social service providers on utility issues, e.g., availability of energy assistance and alternative payment plans. And several utilities provide energy efficiency programs that include low-cost financing and incentives for home energy conservation upgrades. These programs are just examples of ways in which utilities help their low-income customers.

In conclusion, the current credit crisis is having an impact on industry participants, but by and large we are managing through the crisis. Utilities must continue to work closely with the regulatory and financial communities to ensure continued access to sufficient capital on reasonable terms. The industry is facing substantial costs in the next several years. Rates will go up, probably more quickly than at any other time in our history. In view of that fact, we must also provide customers with the tools – such as the smart grid and energy efficiency programs – to control their electricity costs. But without adequate access to capital markets, we may not be able to provide these tools to our customers. We must take the steps necessary to ensure that

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problems in the capital and credit markets do not threaten the ability of utilities to provide environmentally sound and reliable electricity to customers.

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**Exhibit 1: Brattle Group Study on Investment****Table 1: Model Results Overview**

	Reference Scenario No Carbon Policy	RAP Efficiency Base Case Scenario No Carbon Policy	MAP Efficiency Scenario No Carbon Policy	Prism RAP Scenario Carbon Policy
<b>Average Peak Load Growth Rate</b>		0.70%	0.30%	0.70%
<b>New Capacity Through 2030 (in GW)</b>				
Renewables	38.6	39.2	38.8	103.7
Combustion Turbine	25.0	4.3	0.0	5.5
Nuclear	29.1	28.9	28.2	64.0
Conventional Combined Cycle	39.5	12.9	3.8	5.4
Coal	81.8	47.6	42.1	38.9*
<b>Total New Capacity (GW)</b>	<b>214.0</b>	<b>132.9</b>	<b>110.9</b>	<b>215.5</b>
<b>Capital Investment Through 2030 (rounded to nearest billion)</b>				
Generation	\$897	\$605	\$455	\$951
Transmission	\$298	\$298	\$298	\$298
AMI and EE/DR	\$0	\$85	\$192	\$192
Distribution	\$582	\$582	\$582	\$582
<b>Total Capital Investment (\$ Billions)</b>	<b>\$1,577</b>	<b>\$1,470</b>	<b>\$1,527</b>	<b>\$2,023</b>

*Source: Transforming America's Power Industry: The Investment Challenge 2010 – 2030, November 2008, The Brattle Group, prepared by Marc W. Chupka, Robert Earle, Peter Fox-Penner, and Ryan Hledik.*

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**Exhibit 2: S&P Credit Ratings****S&P Long-Term Debt Ratings**

	<b>1970</b>	<b>1980</b>	<b>1990</b>	<b>2000</b>	<b>2007</b>
AAA	14.0%	0.0%	0.0%	0.0%	0.1%
AA	65.6%	32.9%	27.4%	14.1%	1.7%
A	17.4%	43.8%	34.2%	54.6%	28.8%
BBB	3.0%	21.9%	34.3%	26.6%	42.4%
BB or lower	0.0%	1.4%	4.1%	4.7%	27.1%
<b>Proportion by Grouping</b>					
AAA & AA	79.6%	32.9%	27.4%	14.1%	1.8%
BBB or lower	3.0%	23.3%	38.4%	31.3%	69.4%

Source: *America's Electric Utilities: Past, Present, & Future, 8th Edition*,  
by Hyman, Robert C.; Andrew S.; and Leonard S. Table 37.5, page 432, Barclays Capital estimates.

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