

# **Effect of Recession on Delivery and Retail Businesses**

**Mark Kumm**  
**President, Retail Electricity Supply**  
**EEI Fall Legal Conference**  
**October 2009**



# Agenda

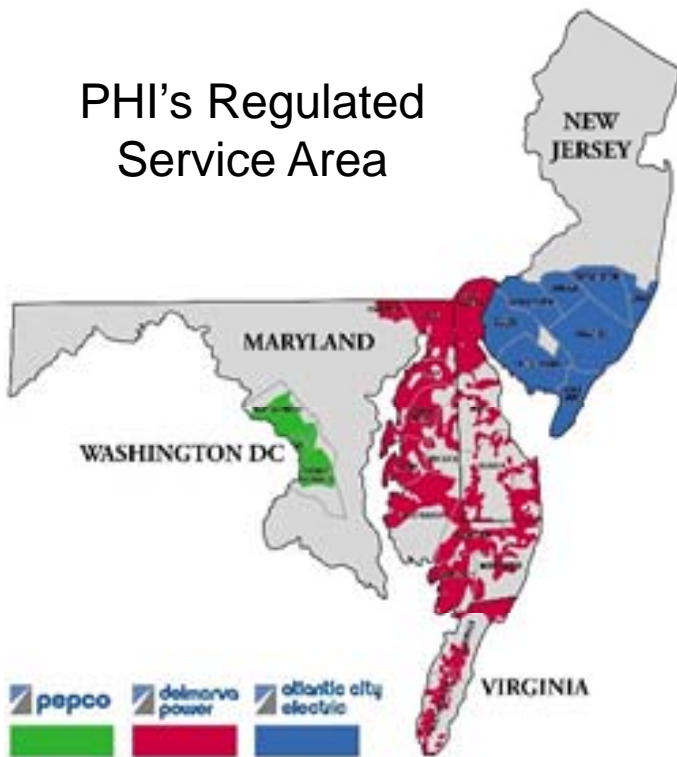
- Pepco Energy Services Overview
- Anticipated Effects of Recession
- PES' Response and Results
- Conclusion



# Pepco Energy Services Overview

- Pepco Energy Services is a wholly owned Subsidiary of Pepco Holdings, Inc. (“PHI”), and an affiliate of three regulated utilities

PHI's Regulated Service Area



- » PHI is *Fortune 500* corporation.
- » NYSE Symbol: POM
- » 2008 Revenue = \$10.7 Billion
- » 2008 Income = \$300 Million

 **Pepco Holdings, Inc**  
Companies

Regulated  
Businesses

 **pepco**

 **atlantic city  
electric**

 **delmarva  
power**

Competitive  
Businesses

 **conectiv  
energy**

 **pepco  
Energy Services**

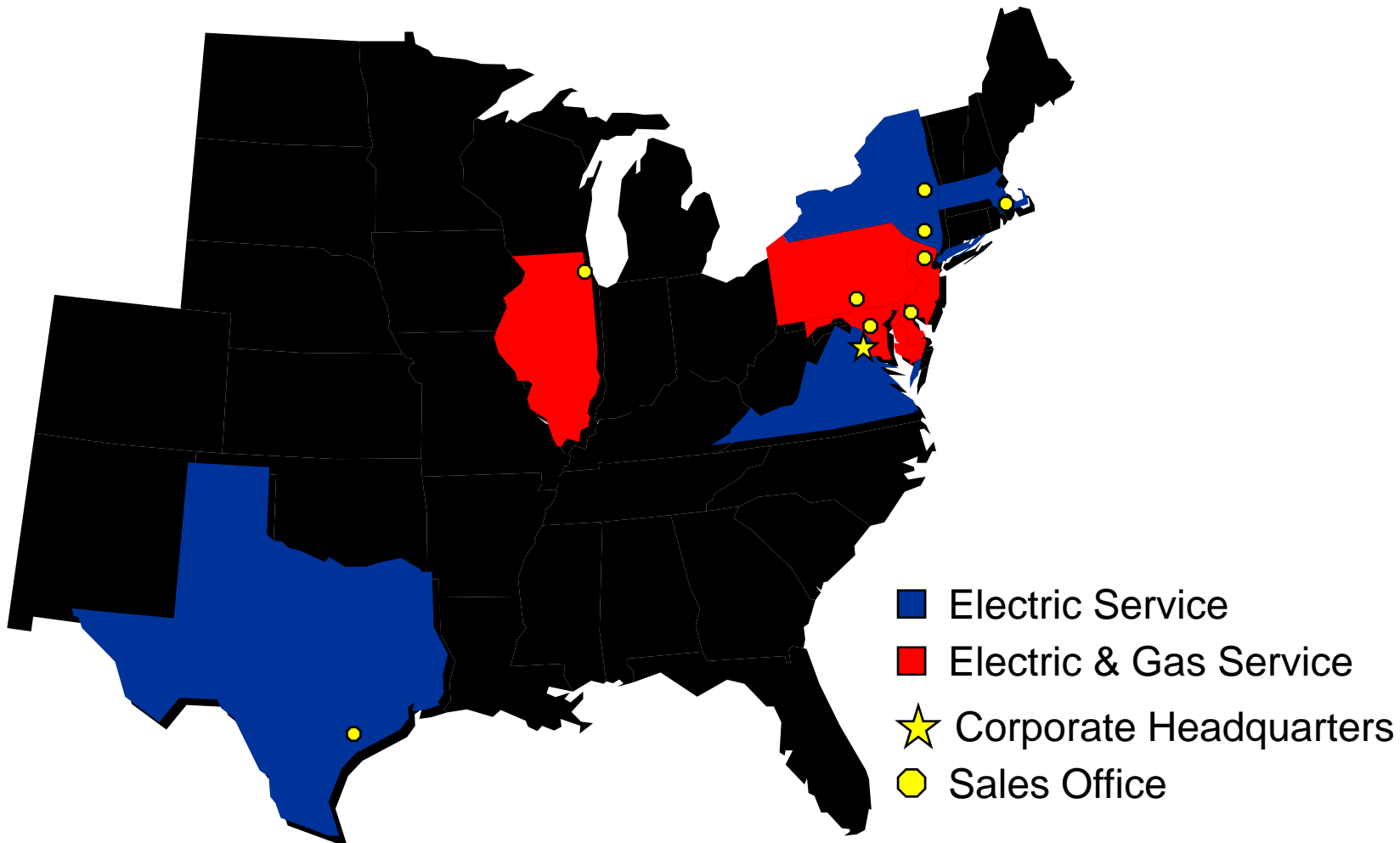
 **pepco  
Energy Services**

# Pepco Energy Services Overview

- **Pepco Energy Services (“PES”)** provides retail energy services, primarily to large commercial, industrial and government customers
- **Energy Supply**
  - Retail electric and natural gas supply
  - Wholesale power generation
- **Energy Services**
  - Energy efficiency and renewable energy
  - Heating and cooling facilities



# PES Energy Supply Service Area

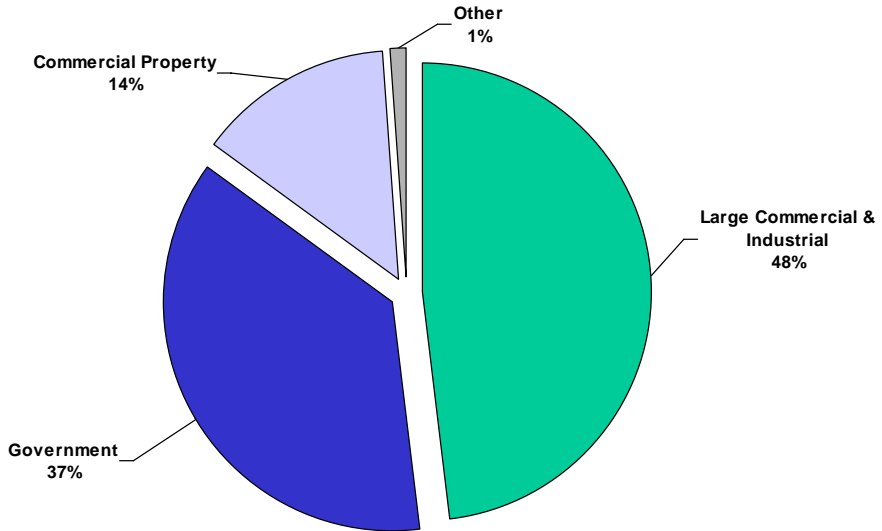


# PES Overview

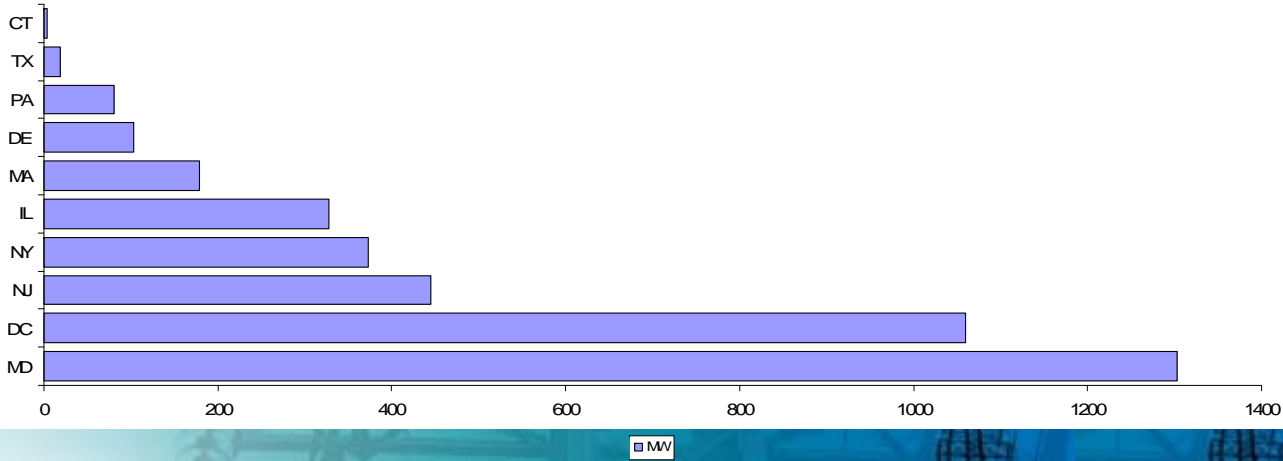
- A top 10 ranked competitive electricity supplier in USA
- Over 3,900 MW of load currently served
- More than 30 Bcf of Natural Gas supplied in 2008



# PES Electric Customer Base, by Capacity Obligation and State



Electric Load Served - August 2009



# Comparison: Competitive Supplier vs. Regulated Utility

• Regulated Utility	• Competitive Supplier
<ul style="list-style-type: none"> <li>– Designated service territory</li> </ul>	<ul style="list-style-type: none"> <li>– Can select the retail markets in which it operates</li> </ul>
<ul style="list-style-type: none"> <li>– Regulated rates</li> </ul>	<ul style="list-style-type: none"> <li>– Can charge market based prices</li> </ul>
<ul style="list-style-type: none"> <li>– Obligation to serve all customers                             <ul style="list-style-type: none"> <li>▪ Ability to set up-front deposit to reduce credit risk</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>– Can select customers to serve                             <ul style="list-style-type: none"> <li>▪ Reduces credit risk</li> </ul> </li> </ul>
<ul style="list-style-type: none"> <li>– Operates with regulated tariffs                             <ul style="list-style-type: none"> <li>▪ Approved by regulating authority</li> <li>▪ Typically have standard language</li> <li>▪ No or limited ability to tailor terms for individual customers</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>– Operates with retail contracts                             <ul style="list-style-type: none"> <li>▪ Ability to tailor terms to individual customer risks</li> <li>▪ Designation of events of default</li> <li>▪ All subject to competitive market forces</li> </ul> </li> </ul>
<ul style="list-style-type: none"> <li>– Limits on ability to disconnect service for nonpayment</li> </ul>	<ul style="list-style-type: none"> <li>– Ability to terminate contract and return customers to utility (except in Texas)</li> </ul>
<ul style="list-style-type: none"> <li>– Several methods available to collect bad debt                             <ul style="list-style-type: none"> <li>▪ Recovery of increases in bad debt typically delayed until next rate case order and subject to regulatory approval</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>– Several methods available to collect bad debt                             <ul style="list-style-type: none"> <li>▪ Failure to collect debt has P&amp;L implications</li> </ul> </li> </ul>

# Anticipated Effects of a Recession

- In early 2008, PES became concerned about the possible consequences of a recession
  - We recognized that there were many favorable factors about our customer base:
    - A large proportion are in the Washington DC area, which has largely been insulated from previous economic downturns
    - A large proportion are federal, state or local government customers
    - A small proportion are small commercial and residential, which have been hard hit by previous recessions
  - Nevertheless, we serve a significant amount of load in markets not as well insulated from previous recessions, and a significant proportion is commercial real estate:
    - Chicago
    - Boston
    - New York

# Anticipated Effects of a Recession

- PES may be unique among competitive energy suppliers in that it relies upon credit insurance to protect it from customer failure to pay:
  - PES insures about 78% of its receivables with a third party insurance company
  - We have relied upon insurance since 2000
- Our credit insurance policy:
  - Is from a US subsidiary of an international financial institution
  - Covers only unpaid accounts receivable
  - Applies for failure to pay in both the normal situation and in bankruptcy
  - Our payments are based on total revenues insured during a policy year
  - Provides PES with review of prospective customer credit quality prior to execution of supply contract
  - However, coverage can be reduced or withdrawn based upon adverse developments with regard to customer.

# PES Response

- Since early 2008, PES has experienced:
  - Increased cancellation of credit insurance by its third party credit insurer for some of our customers (55 contracts, about 240 MW in 2008-09)
  - An increase in the number of customer bankruptcies (8 contracts in 2008-09)
  - An increase in uncollected debt (includes bankruptcies), however this increase remains quite low
  - A decrease in days sales outstanding (DSO)
  - Only a few customers requesting early contract termination and/or reductions in their volumes due to facility closures or process reductions



# Results

Period	%<60 Days	%<90 Days	DSO	Bad Debt Ratio
March 2008	97.0%	98.3%	31	0.03%
June 2008	98.6%	99.3%	28	0.02%
September 2008	98.9%	99.6%	32	0.01%
December 2008	98.4%	99.1%	30	0.01%
March 2009	96.4%	97.5%	26	0.54%
June 2009	96.3%	96.5%	26	0.27%
August 2009	94.5%	96.1%	28	0.23%



# PES Response

- In early 2008, PES increased its monitoring of its accounts receivable and the financial condition of its customers;
  - We established a list of customers that we viewed as having the highest risk of non-payment
    - These consist of non-government accounts with insufficient credit insurance to cover credit exposure, or customers with adverse financial developments
  - We monitor these accounts daily to determine if payments are late, and take the appropriate actions when delinquencies occur
    - We monitor all remaining accounts on a less frequent, but regular basis
  - We established a process for addressing customer request to terminate and notifications of intent to reduce load
    - Our standard contracts permit us to collect increases in cost caused by contract termination or material changes in usage
    - We have had contracts with only 3 customers who have provided notification of a reduction in usage or account closure.
  - We established a process for monitoring customer usage to identify material changes that have occurred without notification



# Response to Insurance Cancellation

- Upon notification of a reduction or cancellation of coverage by credit insurer, PES:
  - Notifies the customer and requests that the customer provide financial information for further credit review/approval
  - When allowed by contract, requires financial assurance in the form of a letter of credit or a bankruptcy-proof security agreement
  - Places the customer on a list of continuously monitored accounts, and provides immediate written and verbal notifications to the customer of any delinquencies

# Response to Bankruptcy

- When active customers have declared bankruptcy:
  - In many cases, third party credit insurance covers some portion of receivables due from customer
  - PES works with its insurance company during the bankruptcy proceeding to pursue claims
  - If the debt is not insured, PES files its Proof of Claim and will participate as required and/or necessary in the bankruptcy proceedings
  - Evaluates offers from companies to purchase our receivables for bankrupt entities



# Response to Non-payment

- PES has used these processes to address customer payment delays and delinquencies
  - Established a list of customers to monitor continuously
    - Heightened internal awareness of aging AR, once account becomes one day delinquent
    - Timely and proactive communications for payment
    - Terminate contract at earliest opportunity
  - Submit claim to insurance company if eligible
  - Sent debt to a third party collections agency or outside counsel
  - Enter into payment arrangements if deemed appropriate
  - Current bad debt ratio, as a percent of revenues is less than 0.3% for 2009 YTD



# Response to Requests to Terminate/Notice of Reduction

- Customers have requested to terminate contracts and/or provided notification of usage reduction
  - PES has experienced a negligible increase in customers making these requests (can we quantify)
  - When requested, the PES retail electricity contract provide remedies, in the form of payment of damages associated with these events
  - In most cases, the customer agrees to pay the damages



# Conclusions

- In general, retail marketers such as PES have more flexibility to respond to changing economic conditions than regulated utilities
  - Although we don't have a mechanism to collect amounts that remain unpaid
- Due to the unique characteristics of its customer base and preventive measures implemented in 2008, the recession has had little financial impact on PES' retail energy supply business
- Proactive measures PES took to protect itself in the event of an economic slow down were worthwhile
  - Increased creditworthiness requirements
  - Heightened internal awareness and response to aging AR
  - Processes to respond to slow and non pay