

AES-COPC Offset Hill Briefing

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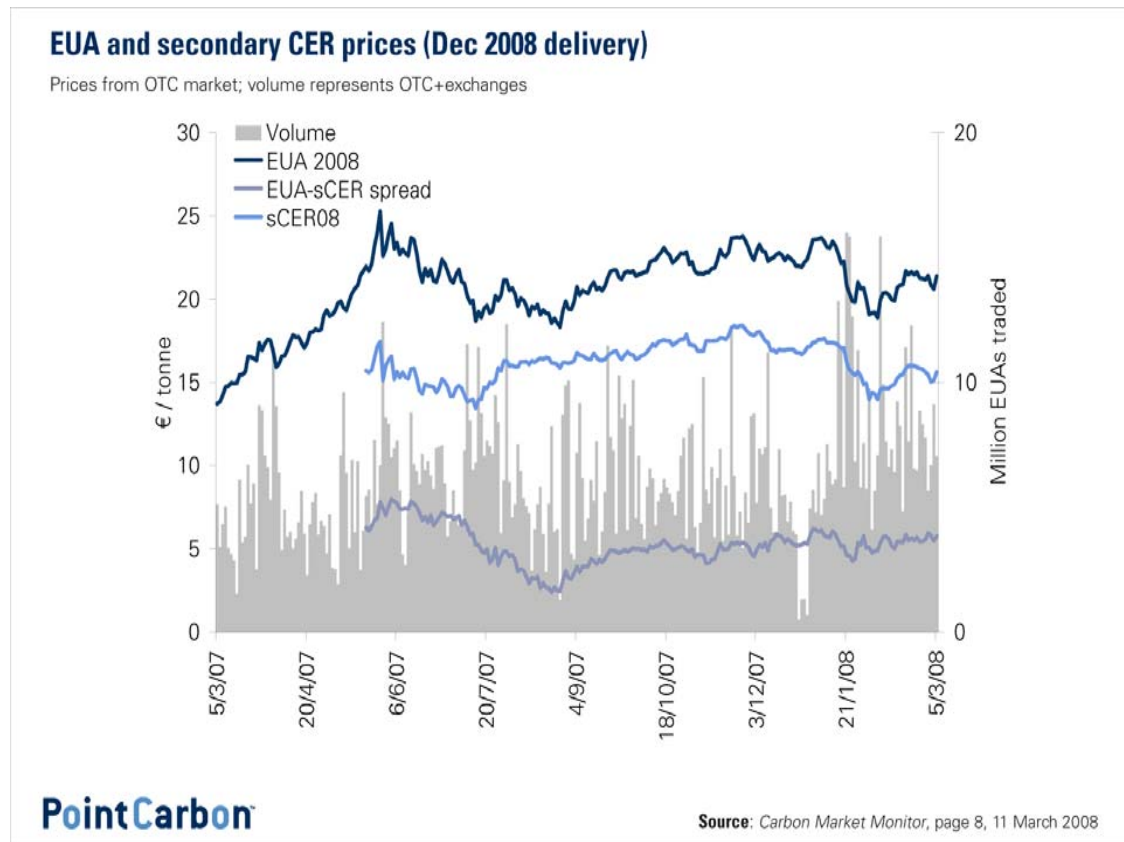
Managing Generation in a GHG Compliance Program

- › There are three broad categories of exposure to a GHG Compliance program for owners of generating facilities
 - Vertically Integrated Utility Generation
 - Merchant Generation
 - Partially or Fully Contracted Generation
- › Financial Impacts vary across the three categories...but all share a common goal...to achieve the lowest variable cost of production
- › Vertically Integrated Utility Generation may or may not have a tariff pass through mechanism. However, if your facility is out of merit due to high compliance costs, there is nothing to pass-through and a full loss of margin is experienced
- › Merchant Generation will be subject to a varying degree of incremental cost recovery based on the ability of the marginal generator in the market to recover its compliance cost
- › Partially or Fully Contracted Generation has further issues associated with a potential disconnect between the contract off-taker utilizing a dispatch price that is not reflective of the generators true variable cost of carbon...this distorts more than just the cost of compliance, but also the achievement of efficient economic dispatch and true reduction in emissions

Liquidity and Correlated Products

- AES operates generating facilities across the European Union and has been subject to compliance GHG markets since 2005
- Of course we also invest in a pipeline of offset projects that create real, scientifically proven GHG reductions

- The EU Compliance product and the Clean Development Mechanism product continue to show dramatic growth in traded volumes and a highly correlated pricing path creating a broad portfolio of hedging alternatives



The Dilemma...

- › Achieving the lowest overall societal cost to meeting the required GHG emissions reductions
 - Attempting to control to a hard cap within a limited geographic or sectoral scope creates a disconnect in the Marginal Abatement Cost Curves (“MAC curves”)
- › Security of Supply is at risk whenever there is uncertain around an Investors ability to recover its investment
 - Generating Facilities require products that allow them to hedge long term Margin expectations

The Solution...

- › Ideally Global Marginal Abatement Cost curves across Borders and Economic Sectors can be melded into one smooth MAC curve
 - The least cost compliance product will be driven out through efficiency of markets
- › Long Term risk can be managed through the Investment in a corresponding Long Term answer
 - Generating Facilities can opt to invest in offset projects to create a portfolio of balanced risk / opportunity that cannot be replicated using only government issued compliance instruments