



Introducing

Rising Constellation

SHATTUCK CHARTS A NEW COURSE

By Martin Rosenberg

MAYO SHATTUCK III, the chairman, president and chief executive officer of Constellation Energy Group stands for a new generation of leadership in the power industry. He is one of more than two dozen CEOs to rise to the upper reaches of utility management since the dawn of this century.

The Baltimore executive has charted a contrarian course for Constellation, staking a claim to all parts of the energy value chain when most of his peers around the country have scrambled to get back to running regulated businesses.

Increasingly, the Constellation story is getting noticed. When Accenture, the global consulting giant, recently conducted a utility conference in Barcelona called "Choosing to Lead," it gave Shattuck marquee placement on its program. *EnergyBiz* caught up with Shattuck immediately prior to his departure for Spain.

energybiz: Tell us about your family and your background.

SHATTUCK: I grew up in Boston, went to Williams College and then went to Stanford University business school. I worked for Bain & Company on the strategy and consulting side for four years. I was a technology investment banker for Alex. Brown, now Deutsche Bank Alex. Brown, until becoming president of the firm in 1991.

energybiz: Williams, a small, fine liberal arts college, is not your typical training ground for a utility executive.

SHATTUCK: I'm a big advocate of the liberal arts. The key is allowing yourself the breadth of experience and exposure to a number of things in order to determine what you might want to do in life.

energybiz: Were you convinced in college that you would pursue a business career?

SHATTUCK: I wasn't. I worked two years at J.P. Morgan before going to business school. My grandfather was a Boston lawyer, and my father was in the investment management business.

energybiz: What did you learn at Stanford?

SHATTUCK: It's small, which creates a great learning environment. It provides the type of curriculum that builds leaders as opposed to functional experts.

energybiz: How many years were you in investment banking?

SHATTUCK: From 1985 to 2001.

energybiz: What was it like?

SHATTUCK: Investment banking is highly transactional and therefore less cerebral than other professions. And it leads one to learn how to make judgments quickly and perhaps with imperfect data. It is certainly a profession where you learn how to make judgments about risk — and that carried forth very much into what I'm doing now.

energybiz: You enjoyed it?

SHATTUCK: There's a tremendous excitement and immediate gratification in the transactional businesses. I was an investment banker who took Sun Microsystems public along with Oracle, Microsoft and others. That was fun and rewarding. On the other end of the spectrum is consulting, which is much more cerebral.

energybiz: What do you think of the book, "Barbarians at the Gate," which deals with the leveraged buyout of RJR Nabisco and the frenzy surrounding mergers and acquisitions in the 1980s?

SHATTUCK: It was the beginning of the broader recognition of the power behind capital — capital as a strategic weapon, and how it was being deployed.

energybiz: How did you get the call to join Constellation?

SHATTUCK: I was on the board at Constellation for about a year and a half before I became CEO. And I was retiring from the banking world after three difficult years of commuting to Frankfurt. I was in the final stages of interviewing for the CEO job with the U.S. Olympic Committee. That's when the Constellation board came to me and asked whether I'd consider becoming the CEO of Constellation.

energybiz: Describe the company's situation at the time.

SHATTUCK: This was four or five weeks before Enron collapsed. Constellation was preparing to split into a merchant and a distribution company, Baltimore Gas and Electric. A lot of very big, strategic decisions had to be made all at once. In October 2001, as I became CEO, two big decisions were made. We did not split the company because it would have put the company in some jeopardy from a balance sheet standpoint. Secondly, we agreed to buy Goldman Sachs' interest in the commodities business. Risk management was bifurcated here

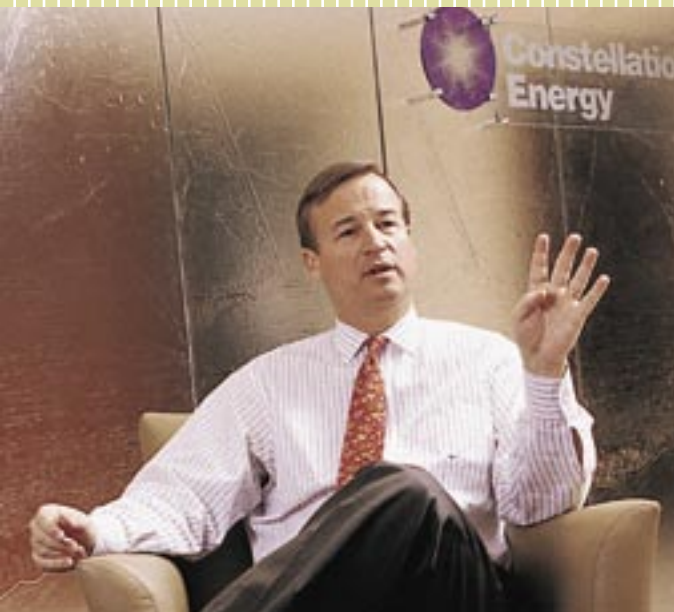


Photo Courtesy of: Constellation Energy

because of Goldman Sachs' involvement with the trading platform. I felt very strongly that that needed to be resolved.

energybiz: What was the corporate culture like early on?

SHATTUCK: At the time, the generation fleet was being spun out from the utility and so you really had disparate and siloed cultures in generation and in the newer merchant world — the trading world. As a consequence, there was a lot of work to be done culturally and organizationally.

energybiz: What was your approach?

SHATTUCK: I came from a bank. I was very comfortable with matrix-like organizations. The siloed organization was reinforced by reporting relationships, and I changed all of that — although somewhat painfully to many people. Culturally we had an organization that had some in the historic mentality of an old utility, feeling entitled and not particularly accountable. We tried to reinforce what we called transformational values: speed, accountability, efficiency, competitiveness. We introduced these values in a variety of ways. One was to change out the management structure by hiring people from outside the industry. We bought New Energy, which is a competitive retail arm, and with New Energy came a sense of entrepreneurial drive and competitiveness, a sense of wanting to win. By making some interesting acquisitions, we actually were able to transform the company faster.

energybiz: Have you gotten to where you hope to be?

SHATTUCK: No. We have made a tremendous transformation, but I doubt we'll ever be complacent. Change is going to be a constant. The message that we try to convey to this organization is that we will be an organization that focuses on continuous improvement.

energybiz: Southern Company spun off its merchant activity into Mirant, which has encountered major

“By making some interesting acquisitions, we actually were able to transform the company faster.”

difficulties. Do you think it was fortuitous that you never got to that point at Constellation?

SHATTUCK: We dealt with the cards we were dealt at the time. Because of the potential split of the company, we had a \$5.5 billion dollar bridge loan on our books right before Enron was to collapse. We were about to head into a capital markets environment that had extreme risk to it. We had to recapitalize immediately to have a chance to figure out what to do strategically. So the best chance was fix the balance sheet was to sell everything that didn't matter — assisted living centers, real estate, leased ships, planes. You name it. We got just ahead of the wave of the capital markets collapse and got that job done. The beginning of 2002, we steadied the ship, and it was time to figure out where to set course.

energybiz: What values guided that process?

SHATTUCK: We had the beginnings of an incredible value proposition for customers. We understood how to sell power outside of our own historic region on a competitive basis, both at the wholesale and retail level. We took the approach of “let's figure out what the customer wants.” That was an insight that preceded the industry by at least a year. We decided to go to that end of the value chain where we believed that the margin could be earned at the customer level through distribution and sales as well as at the manufacturing level. Our insight was that in most manufacturing businesses, there is a value chain where there is margin at both the manufacturing level and at the customer level. We decided to build an organization that was able to capture margin at the customer level, and we had a very good wholesale business. We bought customer contracts from other providers, like Reliant and Dynegy. It allowed us to expand into other geographies. Then we decided we would do the same thing at the commercial and industrial customer level. So we bought New Energy from AES. In a very short period of time we were able to build out a national franchise in all the competitive markets. We went from No. 21 to No. 1 in wholesale electricity sales volumes and we went from nothing to No. 1 in retail in a matter of two years. It was a time when the industry was really trying to go back to basics, back to their regulated roots. Constellation was contrarian. But now that we

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are out of the other end of the tunnel and the competitive markets, particularly the wholesale markets, are thriving. It was obviously a good move for us.

energybiz: Of Constellation's revenue today, what share comes from diversified activities?

SHATTUCK: About 85 percent.

energybiz: How about net income?

SHATTUCK: About 75 percent.

energybiz: You own or hold an interest in 12,000 megawatts of generating capacity in 12 states. Have you been hurt by the recent glut in power supplies, which has pushed down the value of some generating assets?

SHATTUCK: We were fortunately not overexposed in that realm. Yes, we put up a lot of new plants, half of which became very productive because they had power purchase agreements against them. The other half was pure merchants without power purchase agreements. Those are still underperforming assets for the company.

energybiz: What are Constellation's nuclear ambitions?

SHATTUCK: We decided to become a consolidator of nuclear plants. We had two units, and we purchased three units. Now we have five units, and we are considered one of the top nuclear operators. Nuclear is very much a part of our acquisition program. We have a competitive advantage in the nuclear realm.

energybiz: So you see yourself becoming a bigger generator?

SHATTUCK: Yes. Because of our presence on the customer side, it gives us more flexibility to buy or build in competitive markets.

energybiz: Constellation has diversified along the value chain of energy. Do you see any other energy companies doing what you're doing? If the answer is no, do you feel lonely out there by yourself?

SHATTUCK: Plenty of companies think of themselves as being fully integrated, but they are predominantly on the regulated side of the matrix. They are not companies that have the same mix that we have along the value chain on the deregulated side.

energybiz: Constellation is fairly unique in the utility universe in what it is trying to achieve.

SHATTUCK: We very much are, and we are pleased in many respects that the market allowed us to get to this point in a reasonably fast way.

energybiz: You are on Gap Inc.'s board of directors. Would you encourage other utility executives to sit on the boards of retailers?

SHATTUCK: If you are a CEO, it is tremendously valuable to sit on another board. There are a lot of things

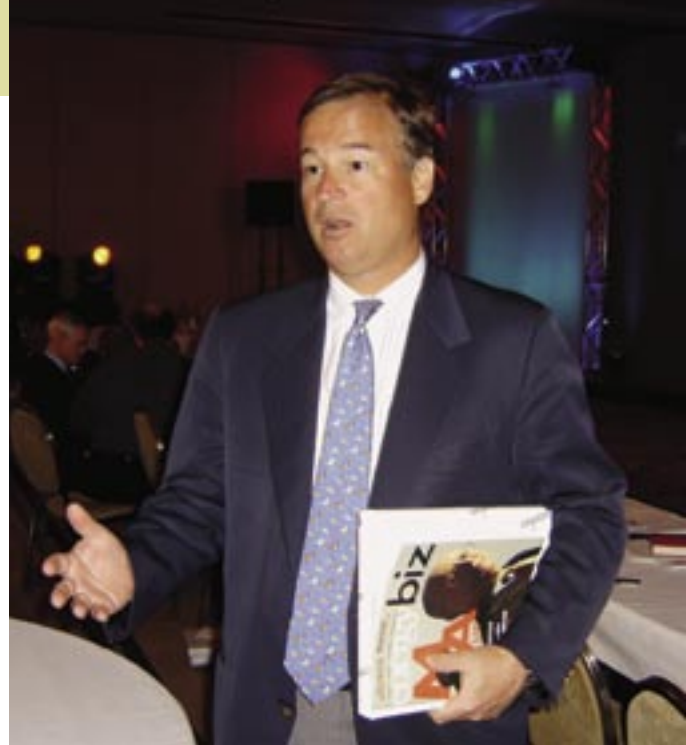


Photo by: Martin Rosenberg

▲ Mayo Shattuck III, after addressing an international conference of energy executives conducted by Accenture in Barcelona, Spain in April.

that you can bring back to your own company that challenges the way in which you approach things.

energybiz: Describe your personal interests.

SHATTUCK: My main hobby is my five children, and they are all terrific. They range from 23 to 2, and every one of them is fascinating. I am also a golfer, although I don't really take it too seriously.

energybiz: What do you think the utility business will look like in a few years?

SHATTUCK: Eventually, the business will actually start its consolidation phase, and I think it's going to be sooner rather than later. There are seven utilities in Japan, a country with about half the population we have. We have about 100. For the sake of efficiency, productivity and working through some of our national policy issues, it would be better — and it's likely — that we'll end up with fewer larger players down the road.

energybiz: So, using your model, as few as 14?

SHATTUCK: How fast it will happen I don't know. There are a lot of regulatory hurdles in the way. But I do think that it'll get to 50 reasonably fast.

energybiz: That begs an obvious question. Given your professional background, do you expect to be a major actor bringing this about?

SHATTUCK: We try to stay in tune with every opportunity to add shareholder value. We have a great independent course. We mostly want to keep our freedom as wide as possible. We want to remain in control of our own destiny and not have something happen to us that we would find undesirable from a shareholder standpoint. ☺

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