

**BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI**

In the Matter of the Application of The Empire District)
Electric Company for Authority to Issue and Sell Under)
Its Existing Indenture of Mortgage and Deed of Trust)
Dated as of September 1, 1944, as Amended and)
Supplemented, up to and Including \$150,000,000)
Principal Amount of Its First Mortgage Bonds, in One)
Or More Series and to, Among Other Things, Execute)
and Deliver a Supplemental Indenture or Indentures)
to Provide for the Terms of Said Bonds)

File No. EF-2014-0195

**STAFF'S RECOMMENDATION TO CONDITIONALLY APPROVE THE
APPLICATION OF THE EMPIRE DISTRICT ELECTRIC COMPANY FOR AUTHORITY
TO ISSUE DEBT IN THE FORM OF FIRST MORTGAGE BONDS**

COMES NOW the Staff of the Missouri Public Service Commission, by and through counsel, and hereby submits its *Recommendation to Conditionally Approve the Application of The Empire District Electric Company for Authority to Issue Debt in the Form of First Mortgage Bonds (Recommendation)*, stating as follows:

1. On December 20, 2013, The Empire District Electric Company (Empire) filed an application requesting authority to issue and sell under its existing indenture of mortgage and deed of trust dated September 1, 1944, as amended and supplemented, up to and including \$150,000,000 in principal amount of its first mortgage bonds, in one or more series and to, among other things, execute and deliver a supplemental indenture or indentures to provide for the terms of said bonds.

2. Since Empire is a Kansas corporation, the Commission has jurisdiction over the proposed issuance and sale of First Mortgage Bonds by Empire, pursuant to Sections 393.180 and 393.190, RSMo 2000, because Empire will create a lien or encumbrance on its Missouri properties to secure payment of the Bonds.

3. In accordance with Section 393.190.1, RSMo 2000, Empire has stated that subjecting its Missouri properties to the lien of its indenture to secure these bonds will have no impact on the tax revenues of the Missouri political subdivisions in which any of

the structures, facilities, or equipment of Empire is located. Further, Empire has stated that the Mortgage will not result in a change of ownership of Empire's Missouri properties or in a change of the present location of the affected utility assets.

4. On December 26, 2013, the Commission issued an Order in this case directing Staff to file a recommendation in this matter. Citing the press of other business, Staff requested more time to review information received from the company before making its recommendation.

5. On January 28, 2014, the Commission granted Staff's request in its *Order Granting Staff's Request for an Extension of Time to File Recommendation*, and directed Staff to file its recommendation no later than March 6, 2014.

6. Accordingly, Staff has prepared this *Recommendation*, which is attached hereto as Appendix A. In the attached Memorandum, Staff recommends that the Commission conditionally authorize Empire to issue debt securities in the form of first mortgage bonds through December 13, 2016 in principal amount of up to and including \$150 million, subject to the following five conditions:

1. That Empire shall make available to the Staff sufficient documentation to ensure that the amount of the funds acquired through issuance of securities under this Application shall be used exclusively for the benefit of Empire's regulated electric utility operations, and not for the other operations of Empire or any of its affiliates or non-regulated activities.
2. That Empire shall be required to file with the Commission all final terms and conditions on this financing including, but not limited to, the aggregate principal amount to be sold or borrowed, price information, estimated expenses, and the loan or indenture agreement concerning each issuance.
3. That the rate on the securities Empire issues be consistent with similar securities of comparable credit quality and maturities issued by other issuers.
4. That Empire shall submit to Financial Analysis any information concerning communications with credit rating agencies in connection with this issuance(s).
5. That nothing in the Commission's order shall be considered a finding by the Commission of the value of these transactions for rate making purposes,

and that the Commission reserves the right to consider the rate making treatment to be afforded these financing transactions and their results in cost of capital, in any later proceeding.

WHEREFORE, Staff recommends the Commission conditionally authorize Empire to issue debt securities in the form of first mortgage bonds through December 13, 2016 in principal amount of up to and including \$150 million, subject to the five conditions stated in Staff's Memorandum.

Respectfully Submitted,

/s/ Tim Opitz

Tim Opitz
Legal Counsel
Missouri Bar No. 65082

Attorney for the Staff of the
Missouri Public Service Commission
P. O. Box 360
Jefferson City, MO 65102
(573) 751-4227 (Telephone)
(573) 751-9285 (Fax)
timothy.opitz@psc.mo.gov

CERTIFICATE OF SERVICE

I hereby certify that copies of the foregoing have been mailed with first-class postage, hand-delivered, transmitted by facsimile or electronically mailed to all counsel of record this 3rd day of March, 2014.

/s/ Tim Opitz

MEMORANDUM

TO: Missouri Public Service Commission Official Case File
Case No. EF-2014-0195, The Empire District Electric Company

FROM: Shana Atkinson, Financial Analysis

Shana Atkinson 03/03/2014
Project Coordinator / Date

Tim Opitz 03/03/2014
Staff Counsel's Office / Date

SUBJECT: Staff recommendation to conditionally approve the Application of The Empire District Electric Company (Empire) for Authority to Issue Debt in the Form of First Mortgage Bonds

DATE: March 3, 2014

The Empire District Electric Company's Proposed Transaction

1.
 - (a) **Type of Issues:** First Mortgage Bonds ("Bonds").
 - (b) **Amount:** Up to and including \$150 million
 - (c) **Rate:** The interest rate used for purposes of creating the pro forma financial statements was 5.00 percent. However, paragraph 8 of Empire's Application indicates that it is requesting Commission authority to issue the Bonds at an interest rate consistent with similar securities of comparable credit quality.
 - (d) **Other Provisions:** Empire will late-file documents setting forth the aggregate principal amount to be sold, price information, and other terms and provisions concerning each issuance of Bonds.
2. **Proposed Date of Transactions:** Through December 13, 2016
3.
 - (a) **Statement of Purpose of the Transaction:** The net proceeds from the sale of each series of Bonds will be added to Empire's general funds for use in connection with the construction, completion, or improvement of its plant or system; the improvement or maintenance of service; the discharge or lawful refunding of its obligations, or the reimbursement of monies actually expended from income or any other monies in the treasury not secured or obtained from the issuance of stocks, bonds, notes or other evidences of indebtedness.
 - (b) **From a financial perspective, does Staff deem this purpose reasonable?**

Yes, with conditions imposed.
4. **Type of Transaction:** Empire anticipates it will issue and sell each new series of Bonds in any of the following ways: (a) in a public offering through an underwriter or underwriters,

or dealer or dealers, (b) in a private placement directly to a limited number of purchasers or a single purchaser, or (c) in an offering through agents.

5. Copies of executed instruments defining terms of the proposed transaction:

Such instruments have not been executed at the time of filing, but Empire has made a commitment to provide the terms and conditions of the instruments when they are available.

6. Certified copy of resolution of the directors of applicant, or other legal documents authorizing the proposed transaction reviewed:

Yes.

7. Pro-forma Balance Sheet and Income Statement reviewed:

Yes.

8. Capital expenditure schedule reviewed:

Yes.

9. Journal entries are required to be filed by the Company to allow for the Fee Schedule to be applied:

No.

10. Recommendation of the Staff:

Conditional Approval (see Comments and Recommended Conditions).

COMMENTS:

Empire is an operating public utility engaged in the business of generating, purchasing, transmitting, distributing and selling electric energy in parts of Missouri, Kansas, Arkansas and Oklahoma. Empire's electric segment sales represent approximately 90.3% of their gross operating revenues in 2013. Empire's Missouri electric utility operations comprised 89.8% of its 2013 retail electric revenues. Empire also distributes natural gas through its subsidiary, The Empire District Gas Company (EDG), which comprised 8.4% of Empire's 2013 gross operating revenues.

Empire filed a Registration Statement with the Securities and Exchange Commission (SEC) on December 13, 2013, for its \$200 million universal shelf registration of common stock, preference stock, unsecured debt securities and first mortgage bonds.

On December 20, 2013 the Company filed an Application requesting that the Missouri Public Service Commission (Commission) authorize Empire to issue and sell under its existing Indenture of Mortgage and Deed of Trust up to and including \$150 million principal amount of its First Mortgage Bonds in one or more series. Because Empire has yet to execute the First Mortgage Bonds in which it requests Commission Authority to issue, Empire's Application does not provide specific terms and conditions of the proposed financing. While Staff believes it is reasonable for the Commission to provide Empire the authority to issue First Mortgage Bonds without the specific terms and conditions, Staff recommends the Commission require that these final terms and conditions be subsequently filed with the Commission in this case to ensure a permanent record of the final terms and conditions of the financing authorized. Staff notes 4 CSR 240-3.120(2) states that companies must submit final terms and conditions before final Commission authority will be granted. Empire's Application in this case states that the Company will file the final terms and conditions with the Commission as a late-filed exhibit.

The Company's Application respecting the purpose of the Bonds states that the proceeds from the sale of each series of the Bonds may be used to provide financing for its construction program, to discharge long-term indebtedness by the payment of principal at maturity, to refinance outstanding indebtedness, including the payment of applicable redemption premiums, and for other corporate purposes. The Application does not identify the specific projects that may be funded by the \$150 million in proposed Bonds, other than a construction budget summary for the authority period (2014 through 2016) provided in response to Staff Data Request No. 0004, which provides potential uses for the Bonds.

Empire requests the financing be approved for use for a broad set of circumstances. If the financing is approved to be used for "other corporate purposes," as stated in the Application, then this could apply to virtually any use. Because the financing request proposes to use Empire's Missouri electric utility properties to secure the debt, it is prudent to require that the amount of funds from this financing authority only be used for purposes that benefit Empire's electric utility properties.

In its Application, the company seeks authority to issue long-term indebtedness secured by its Missouri regulated utility properties at interest rates consistent with similar securities of comparable credit quality and maturities issued by other companies. The pro forma financial statements provided as Appendix 4 and the pro forma financial statements provided in response to Staff data request No. 0001 assume an interest rate of 5% for newly issued debt. Staff looked at Reuters Corporate Spreads for Utilities from BondsOnline and found the average for the last three months (November 2013, December 2013 and January 2014) for 'BBB' rated, 30-year public utility bond yields to be 5.53%. Therefore Empire's assumed interest rate of 5% in its pro forma financial statements appears to be reasonable.

Staff has reviewed the pro forma financial statements that were provided by Empire in response to Staff Data Request No. 0001. Staff relied on Empire's representations made in those financial statements when analyzing the effect of the \$150 million in proposed financing. The pro forma

financial statements anticipate the issuance of a maximum of \$150 million in debt, whether secured or unsecured, through 2016. Because Empire is a Kansas Corporation, based on the opinions of the Company's counsel and the Commission's Staff Counsel's Office, Empire is required to have Commission authority to issue financing only when that financing pledges, assigns, leases, transfers, mortgages, or otherwise encumbers its Missouri utility properties. Consequently, to the extent that Empire also issues unsecured financing over the next three years, that debt would not reduce Empire's \$150 million capacity of secured debt that may be authorized by the Commission in this application.

Staff's recommendation for approval of the secured financing is based on the capital mix that is currently projected to be employed by Empire in its pro forma financial statements. Currently, Empire's pro formas anticipate issuing \$150 million of debt, whether secured or unsecured, and \$50 million of common equity. If Empire were to deviate significantly from these projections, then the capital structures that Staff analyzed in the pro forma financial statements may be different.

Staff also evaluated the impact of the proposed financing on three financial ratios in which benchmarks were published in the September 18, 2012 Standard and Poor's (S&P) article, "Methodology: Business Risk/Financial Risk Matrix Expanded" (see Attachment 1). These three ratios are the Funds From Operations (FFO) to Total Debt ratio, the Total Debt to Total Capital ratio, and the Total Debt to Earnings Before Interest, Taxes, Depreciation and Amortization (EBITDA) ratio. Empire's current S&P credit rating of 'BBB' is based on S&P's current classification of Empire's Business Risk Profile (BRP) as 'Excellent' and its Financial Risk Profile (FRP) as 'Aggressive.'

The most recent S&P research report on Empire dated March 7, 2013 provided Empire's 2012 FFO to Total Debt, Total Debt to Total Capital and Debt/EBITDA ratios. Staff compared this information to Empire's pro forma calculations of these ratios for 2014 through 2016 provided in response to Staff Data Request No. 0001 (see Highly Confidential Schedule 1). Staff believes these calculations are generally consistent with S&P's methodology.

According to the March 7, 2013 S&P research report on Empire, Empire's 2012 consolidated Adjusted FFO to Total Debt ratio is within the FRP range of 'Significant' and the consolidated Adjusted Total Debt to Total Capitalization and Debt/EBITDA ratios are both within the FRP range of 'Aggressive.' Combine the overall 'Aggressive' FRP of these three 2012 ratios with Empire's BRP of 'Excellent', and it is consistent with the benchmark for a 'BBB' credit rating under S&P's matrix.

Empire's pro formas for fiscal year 2014 and 2015 illustrate that the FFO to Total Debt, Total Debt to Total Capital and Debt/EBITDA ratios are all within the FRP range of 'Aggressive.' Assuming Empire would continue to have an 'Excellent' BRP in 2014 and 2015, this would be consistent with a 'BBB' credit rating under S&P's matrix. Empire's fiscal year 2016 pro formas show that the FFO to Total Debt and Total Debt to Total Capital ratios are both within the FRP of 'Aggressive' and the Debt/EBITDA is within the FRP range of 'Significant.'

Consequently, Empire's requested secured debt authority will not jeopardize its investment grade credit rating, assuming all else is held constant.

OTHER ISSUES:

The Staff has verified that Empire has filed its annual report and is not delinquent on any assessment.

RECOMMENDED CONDITIONS:

Staff recommends that the Commission approve the Application submitted by Empire in this case subject to the following conditions:

1. That Empire shall make available to the Staff sufficient documentation to ensure that the amount of the funds acquired through issuance of securities under this Application shall be used exclusively for the benefit of Empire's regulated electric utility operations, and not for the other operations of Empire or any of its affiliates or non-regulated activities.
2. That Empire shall be required to file with the Commission all final terms and conditions on this financing including, but not limited to, the aggregate principal amount to be sold or borrowed, price information, estimated expenses, and the loan or indenture agreement concerning each issuance.
3. That the rate on the securities Empire issues be consistent with similar securities of comparable credit quality and maturities issued by other issuers.
4. That Empire shall submit to Financial Analysis any information concerning communications with credit rating agencies in connection with this issuance(s).
5. That nothing in the Commission's order shall be considered a finding by the Commission of the value of these transactions for rate making purposes, and that the Commission reserves the right to consider the rate making treatment to be afforded these financing transactions and their results in cost of capital, in any later proceeding.

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of the Application of The Empire)
District Electric Company for Authority to Issue)
and Sell Under Its Existing Indenture of Mortgage)
and Deed of Trust Dated as of September 1, 1944,)
as Amended and Supplemented, up to and)
Including \$150,000,000 Principal Amount of Its)
First Mortgage Bonds, in One or More Series and)
to, Among Other Things, Execute and Deliver a)
Supplemental Indenture or Indentures to Provide)
for the Terms of Said Bonds)

File No. EF-2014-0195

AFFIDAVIT OF SHANA ATKINSON

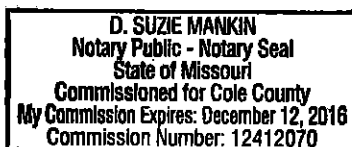
STATE OF MISSOURI)
) ss.
COUNTY OF COLE)


Shana Atkinson, of lawful age, on her oath states: that she has participated in the preparation of the foregoing Staff Recommendation in memorandum form, to be presented in the above case; that the information in the Staff Recommendation was developed by her; that she has knowledge of the matters set forth in such Staff Recommendation; and that such matters are true and correct to the best of her knowledge and belief.



Shana Atkinson

Subscribed and sworn to before me this 3rd day of March, 2014.





Notary Public

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Criteria | Corporates | General:

Methodology: Business Risk/Financial Risk Matrix Expanded

Criteria Officer:

Mark Puccia, Managing Director, New York (1) 212-438-7233; mark.puccia@standardandpoors.com

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Business Risk/Financial Risk Framework

Updated Matrix

Financial Benchmarks

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Methodology: Business Risk/Financial Risk Matrix Expanded

(Editor's Note: We originally published this criteria article on Sept. 18, 2012. We're republishing it following our periodic review completed on Sept. 11, 2013. This article has been partially superseded by the article titled, "Corporate Methodology," published on Nov. 19, 2013, for issuers within the scope of that criteria, but remains in effect for the following sectors or entities: project finance entities, project developers, transportation equipment leasing, auto rentals, commodities trading, investment holding companies and companies that maximize their returns by buying and selling equity holdings over time, Japanese general trading companies, corporate securitizations, nonprofit and cooperative organizations, master limited partnerships, general partnerships of master limited partnerships, and other entities whose cash flows are primarily derived from partially owned equity holdings.

Table 1 in this criteria article supersedes table 1 in the articles titled: Key Credit Factors: "Global Criteria For Rating Real Estate Companies," published on June 21, 2011; "Methodology And Assumptions On Risks In The Global High Technology Industry," published Oct. 15, 2009; "Methodology And Assumptions On Business And Financial Risks In The U.S. Movie Exhibitors Industry," published Aug. 28, 2009; "Methodology And Assumptions On Risks In The Hotel And Lodging Industry," published Aug. 11, 2009; "Methodology And Assumptions On Risks In The Aerospace And Defense Industries," published June 24, 2009; "Methodology And Assumptions On Risks In The Mining Industry," published June 23, 2009; "Business And Financial Risks In The Auto Component Suppliers Industry," published Jan. 28, 2009; "Business And Financial Risks In The Global Pharmaceutical Industry," published Jan. 22, 2009; "Business And Financial Risks In The U.S. For-Profit Health Care Facilities Industry," published Jan. 21, 2009; "Business And Financial Risks In The Investor-Owned Utilities Industry," Nov. 26, 2008; "Business And Financial Risks In The Commodity And Specialty Chemical Industry," published Nov. 20, 2008; "Business And Financial Risks In The Global Building Products And Materials Industry," Nov. 19, 2008; and "Business And Financial Risks In The Retail Industry," published Sept. 18, 2008.)

1. Standard & Poor's Ratings Services is refining its methodology for corporate ratings related to its business risk/financial risk matrix, which we published as part of "2008 Corporate Ratings Criteria" on April 15, 2008. We subsequently updated this matrix in the article "Criteria Methodology: Business Risk/Financial Risk Matrix Expanded," published May 27, 2009. In order to provide greater transparency on the methodology used to evaluate corporate ratings, this article updates table 1 of the May 27, 2009, article to reflect how we analyze companies with an excellent business risk profile and minimal financial risk profile, as well as companies with a vulnerable business risk profile and a highly leveraged financial risk profile. This article amends and supersedes both the 2008 and 2009 articles mentioned above. This article is related to "Principles Of Credit Ratings," published on Feb. 16, 2011.
2. We introduced the business risk/financial risk matrix in 2005. The relationships depicted in the matrix represent an essential element of our corporate analytical methodology (see table 1).

Table 1

Business And Financial Risk Profile Matrix

Business Risk Profile	--Financial Risk Profile--					
	Minimal	Modest	Intermediate	Significant	Aggressive	Highly Leveraged
Excellent	AAA/AA+	AA	A	A-	BBB	--

Table 1

Business And Financial Risk Profile Matrix (cont.)						
Strong	AA	A	A-	BBB	BB	BB-
Satisfactory	A-	BBB+	BBB	BB+	BB-	B+
Fair	--	BBB-	BB+	BB	BB-	B
Weak	--	--	BB	BB-	B+	B-
Vulnerable	--	--	--	B+	B	B- or below

These rating outcomes are shown for guidance purposes only. Actual rating should be within one notch of indicated rating outcomes.

3. The rating outcomes refer to issuer credit ratings. The ratings indicated in each cell of the matrix are the midpoints of a range of likely rating possibilities. This range would ordinarily span one notch above and below the indicated rating.

Business Risk/Financial Risk Framework

4. Our corporate analytical methodology organizes the analytical process according to a common framework, and it divides the task into several categories so that all salient issues are considered. The first categories involve fundamental business analysis; the financial analysis categories follow.
5. Our ratings analysis starts with the assessment of the business and competitive profile of the company. Two companies with identical financial metrics can be rated very differently, to the extent that their business challenges and prospects differ. The categories underlying our business and financial risk assessments are:

Business risk

- Country risk
- Industry risk
- Competitive position
- Profitability/Peer group comparisons

Financial risk

- Accounting
 - Financial governance and policies/risk tolerance
 - Cash flow adequacy
 - Capital structure/asset protection
 - Liquidity/short-term factors
6. We do not have any predetermined weights for these categories. The significance of specific factors varies from situation to situation.

Updated Matrix

7. We developed the matrix to make explicit the rating outcomes that are typical for various business risk/financial risk combinations. It illustrates the relationship of business and financial risk profiles to the issuer credit rating.
8. We tend to weight business risk slightly more than financial risk when differentiating among investment-grade ratings.

Conversely, we place slightly more weight on financial risk for speculative-grade issuers (see table 1, again).

9. This version of the matrix represents a refinement--not any change in rating criteria or standards--and, consequently, no rating changes are expected. However, the expanded matrix should enhance the transparency of the analytical process.

Financial Benchmarks

Table 2

Financial Risk Indicative Ratios (Corporates)

	FFO/Debt (%)	Debt/EBITDA (x)	Debt/Capital (%)
Minimal	greater than 60	less than 1.5	less than 25
Modest	45-60	1.5-2.0	25-35
Intermediate	30-45	2-3	35-45
Significant	20-30	3-4	45-50
Aggressive	12-20	4-5	50-60
Highly Leveraged	less than 12	greater than 5	greater than 60

How To Use The Matrix--And Its Limitations

10. The rating matrix indicative outcomes are what we typically observe--but are not meant to be precise indications or guarantees of future rating opinions. Positive and negative nuances in our analysis may lead to a notch higher or lower than the outcomes indicated in the various cells of the matrix.
11. In certain situations there may be specific, overarching risks that are outside the standard framework, e.g., a liquidity crisis, major litigation, or large acquisition. This often is the case regarding issuers at the lowest end of the credit spectrum--i.e., the 'CCC' category and lower. These ratings, by definition, reflect some impending crisis or acute vulnerability, and the balanced approach that underlies the matrix framework just does not lend itself to such situations.
12. Similarly, some matrix cells are blank because the underlying combinations are highly unusual--and presumably would involve complicated factors and analysis.
13. The following hypothetical example illustrates how the tables can be used to better understand our rating process (see tables 1 and 2).
14. We believe that Company ABC has a satisfactory business risk profile, typical of a low investment-grade industrial issuer. If we believed its financial risk were intermediate, the expected rating outcome should be within one notch of 'BBB'. ABC's ratios of cash flow to debt (35%) and debt leverage (total debt to EBITDA of 2.5x) are indeed characteristic of intermediate financial risk.
15. It might be possible for Company ABC to be upgraded to the 'A' category by, for example, reducing its debt burden to the point that financial risk is viewed as minimal. Funds from operations (FFO) to debt of more than 60% and debt to

EBITDA of only 1.5x would, in most cases, indicate minimal financial risk.

16. Conversely, ABC may choose to become more financially aggressive--perhaps it decides to reward shareholders by borrowing to repurchase its stock. It is possible that the company may fall into the 'BB' category if we view its financial risk as significant. FFO to debt of 20% and debt to EBITDA of 4x would, in our view, typify the significant financial risk category.
17. Still, it is essential to realize that the financial benchmarks are guidelines, neither gospel nor guarantees. They can vary in nonstandard cases: For example, if a company's financial measures exhibit very little volatility, benchmarks may be somewhat more relaxed.
18. Moreover, our assessment of financial risk is not as simplistic as looking at a few ratios. It encompasses:
 - A view of accounting and disclosure practices;
 - A view of corporate governance, financial policies, and risk tolerance;
 - The degree of capital intensity, flexibility regarding capital expenditures and other cash needs, including acquisitions and shareholder distributions; and
 - Various aspects of liquidity--including the risk of refinancing near-term maturities.
19. The matrix addresses a company's standalone credit profile, and does not take account of external influences, which would pertain in the case of government-related entities or subsidiaries that in our view may benefit or suffer from affiliation with a stronger or weaker group. The matrix refers only to local-currency ratings, rather than foreign-currency ratings, which incorporate additional transfer and convertibility risks. Finally, the matrix does not apply to project finance or corporate securitizations.

Related Criteria And Research

- Principles Of Credit Ratings, Feb. 16, 2011
 - Criteria Methodology: Business Risk/Financial Risk Matrix Expanded, May 27, 2009
 - 2008 Corporate Ratings Criteria, April 15, 2008
20. These criteria represent the specific application of fundamental principles that define credit risk and ratings opinions. Their use is determined by issuer- or issue-specific attributes as well as Standard & Poor's Ratings Services' assessment of the credit and, if applicable, structural risks for a given issuer or issue rating. Methodology and assumptions may change from time to time as a result of market and economic conditions, issuer- or issue-specific factors, or new empirical evidence that would affect our credit judgment.

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