BEFORE THE

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

DOCKET NOS. UE-060266/UG-060267

ICNU'S RESPONSE TO PSE'S DATA REQUEST NO. 22

Data Request No. 22:

(Ref. M. Gorman Testimony, p. 28, ll. 11-16)

Please provide copies of, and citations, to any and all workpapers, articles, or publications (including but not limited to any electronic workpapers, articles, or publications) relied upon by Mr. Gorman that substantiate Mr. Gorman's following assertion:

> While PSE is in the midst of a large construction program, this is not unusual in today's marketplace. Indeed, the utility industry in general is in the midst of significant construction programs and many utilities are attracting capital to make significant investments in generation, transmission, and distribution assets. The bottom line is that the utility industry is now in a construction cycle, and the utility industry in general has greater construction risk today than it had a few years ago.

Response to Data Request No. 22:

Copies are attached.

Date: August 11, 2006
Respondent: Michael Gorman
Witness: Michael Gorman

Attachment PSE DR No. 22 to ICNU

STANDARD &POOR'S

Credit Ratings - Commentary & News

Credit Ratings

Print

First-Quarter U.S. Utility Upgrades Outpaced Downgrades, But Momentum Is Likely To Change

Primary Credit Analyst:
Barbara A Eiseman, New York (1) 212-438-7666;
barbara_eiseman@standardandpoors.com
Secondary Credit Analyst:
Brendan Dalton, New York;
brendan_dalton@standardandpoors.com

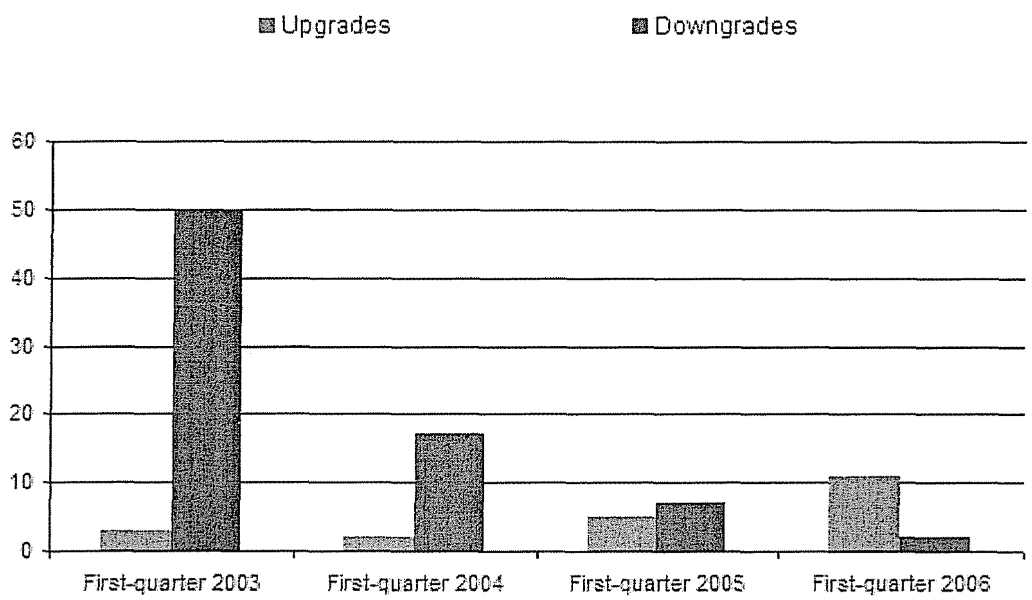
Publication date: 27-Apr-06, 10:12:18 EST
Reprinted from RatingsDirect

Quick Links

Rating actions in the U.S. investor-owned utility industry (electric, gas, pipeline, and water companies) during the first quarter of 2006 closely mirrored that of last year's first three months. Since Jan. 1, 2006, Standard & Poor's Ratings Services recorded 11 upgrades (six of which relate to Allegheny Energy Inc.) of holding companies and operating subsidiaries, compared with just two downgrades. (See chart 1.)

Chart 1

U.S. Utility Rating Changes



The principal drivers of the upside rating activity were improving financial measures in conjunction with strong business profiles, and the acquisition of a financially stronger entity. Although upgrades dominated this quarter, we do not expect this upward momentum to continue in light of the various business and financial pressures many companies face, and given the numerous new negative CreditWatch listings and outlook revisions to negative from stable in the first quarter.

The outlook for the industry remains generally stable. Much of the industry continues to re-emphasize core competencies, where risks are certainly more familiar, but still daunting. These include major pending regulatory decisions, the need for substantial infrastructure expenditures, fuel cost recovery in a high-fuel-price environment, and still low, but gradually rising, interest rates. In addition, event risk, specifically mergers and acquisitions,

ICNU Cross Exh. No.___
Docket No. UE-060266

is a significant development with the repeal of the Public Utility Holding Company Act.

Credit trends in the merchant energy segment have been relatively stable. Excess capacity in certain energy markets will continue to present a challenging operating environment for merchant generators despite financial restructurings. The creditworthiness of many purely merchant power companies is constrained by fluctuating cash flow from operations despite some improvement in power markets in certain regions. One bright spot in this otherwise dim market are merchant coal and nuclear plants that benefit from low generation costs in markets where gas costs set power prices.

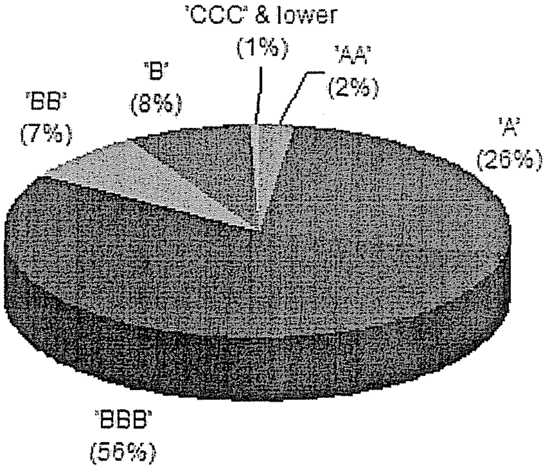
Industry Ratings Still Hover Around 'BBB'

The ratings distribution for the energy sector in recent years has changed slightly, but not enough to shift the average rating out of the 'BBB' category. The percentage of companies carrying ratings in the 'BBB' category ('BBB+', 'BBB', and 'BBB-') has risen to nearly 56% from 49% one year ago and the percentage of utilities rated 'A-' and above has declined to 28% from 34% at March 31, 2005 (see chart 2).

Chart 2

U.S. Utility Ratings Distribution

First-quarter 2006

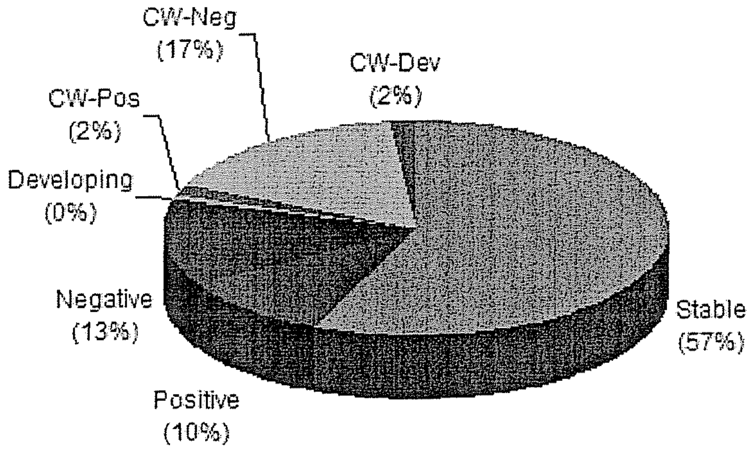


Ratings in the speculative-grade sector have been relatively steady, with about 16% falling in this category. Only 11% of the industry has positive credit outlooks or are listed on CreditWatch with positive implications. Although the number of negative outlooks has diminished considerably to 30, or 15%, from 93, or 30%, from one year ago, the number of companies with negative CreditWatch listings has climbed dramatically to 50, or nearly 17%, from 11 (4%) 12 months ago (see chart 3). The drop in negative outlooks is a result of ratings that have been lowered that carried a negative credit outlook. The increase in the number of companies placed on CreditWatch negative is largely a result of acquisitions, regulatory uncertainties, and eroding financial conditions. A further increase in merger and acquisition activity, which Standard & Poor's expects, will also weigh heavily on creditworthiness over the intermediate term.

Chart 3

U.S. Utility Outlook Distribution

First-quarter 2006

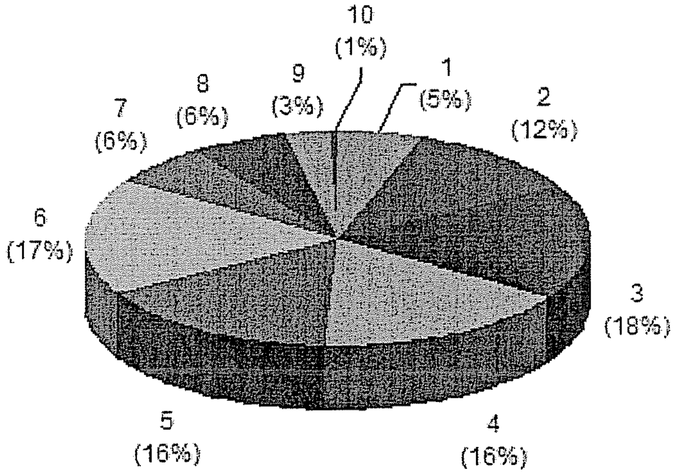


The U.S. power sector is relatively highly rated, certainly compared with the average 'BB' category for U.S. industrial companies. This is a function of the large percentage of firms (about 84%) carrying business profiles of '6' (satisfactory) and stronger (see chart 4). A company's business profile is assessed on a '1' to '10' scale (where '1' represents excellent and '10' vulnerable), and incorporates an analysis of the qualitative factors of management, competitive positioning, operations, markets, and regulation (if appropriate), as well as unregulated businesses, typically merchant generation and energy trading and marketing.

Chart 4

U.S. Utility Business Profile Distribution

First-quarter 2006



Note: Utility business risk profiles are categorized from '1' (excellent) to '10' (vulnerable).

↑back to top

Credit Metrics Stabilizing

Based on a significant sampling of U.S. utilities, total debt to total capital, including hybrid preferred securities and off-balance-sheet obligations, stood at 59.3% at Dec. 31, 2005 (the latest period in which comparable data are available), exactly the same ratio posted at the end of 2004, but notably stronger than the 62% recorded at the end of 2001. This level of debt, while just one measure of financial health, is characteristic of a 'BBB-' and 'BB+' category credit with a satisfactory '5' or '6' business profile. Other measures of bondholder protection slipped following years of gradual improvement. The erosion can be traced largely due to contributions to pension plans, hurricane-related expenses, decreases in deferred taxes, and rate reductions. In this regard, adjusted funds from operations (FFO) to average total debt for 2005 was just 17.1% compared with 19.1% calculated in 2004 and 16.6% recorded in 2001. This ratio is suitable for utilities in the high 'BB' rating category. FFO interest coverage also fell, hovering around 3.6x versus 3.82x posted in 2004 and 3.33x in 2001 (see charts 5, 6, 7, and 8). In the absence of timely rate adjustments by regulators, Standard & Poor's expects key bondholder protection parameters to continue to deteriorate given expectations for rising interest rates and accelerating capital-spending programs.

Chart 5

Adjusted Funds From Operations Interest Coverage

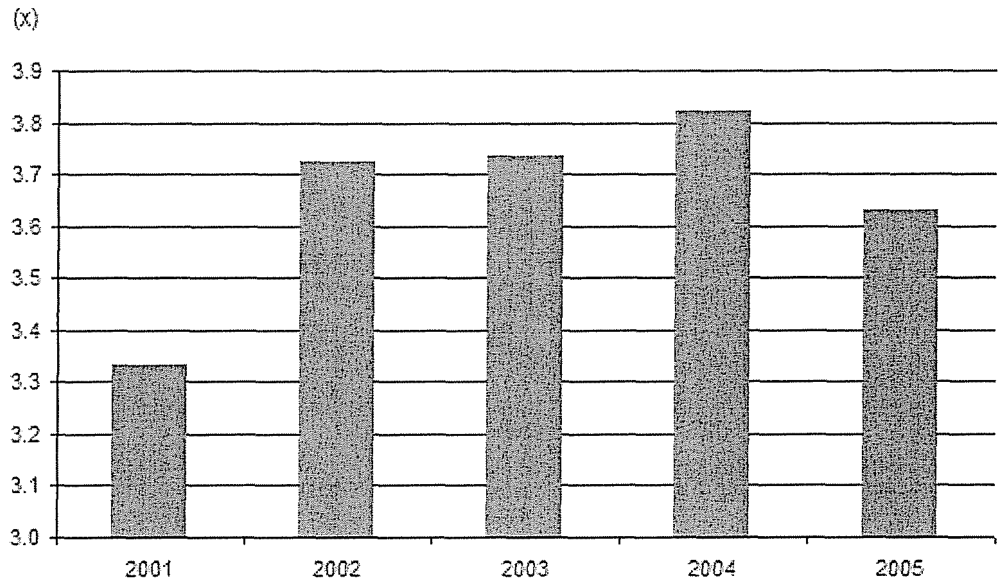


Chart 6

Adjusted Funds From Operations To Avg. Total Debt

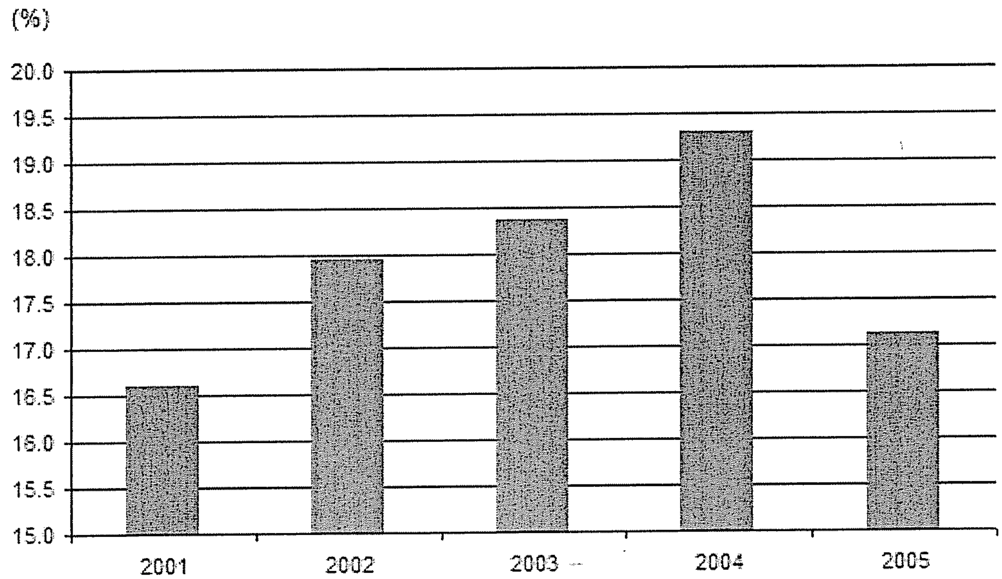
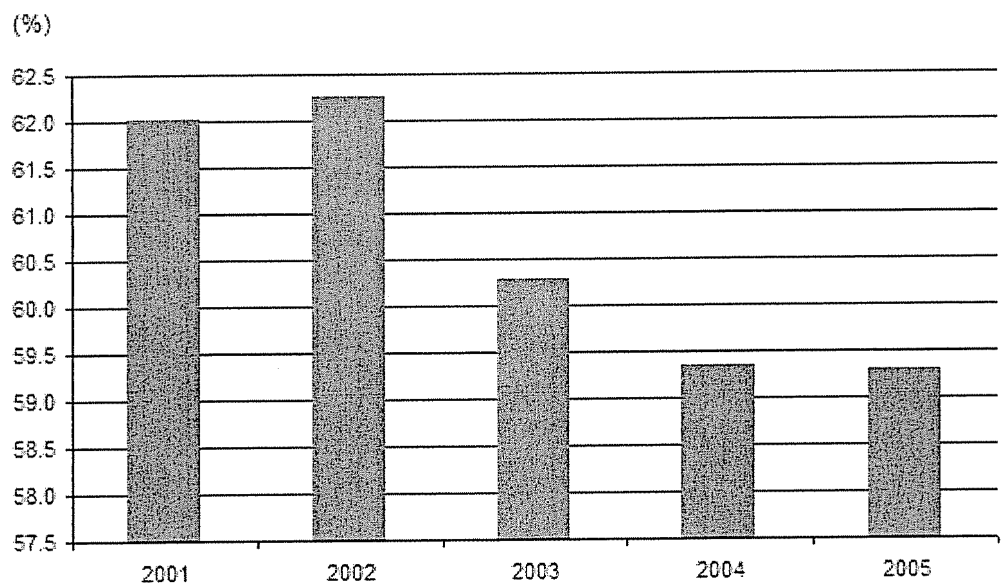


Chart 7

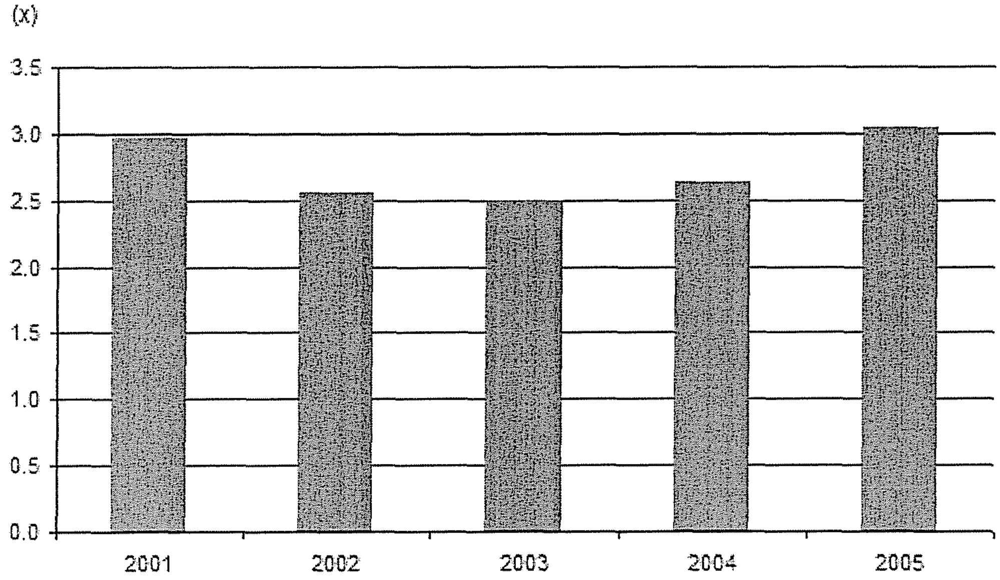
Adjusted Total Debt To Total Capital



 ICNU Cross Exh. No.___
Docket No. UE-060266
Page 7 of 24

Chart 8

Adjusted EBIT Interest Coverage



↑back to top

Capital Market Update

Financing activity for the U.S. power industry has increased significantly in the past 12 months. The amount of medium- to long-term debt, preferred stock, and hybrid securities issued during the first quarter of this year was about $15.4 billion, compared with approximately $11.2 billion during the first three months of 2005. The accelerating reliance on external capital can be traced to a number of factors, among them rising, but still relatively low, interest rates, environmental projects, nuclear station upgrades, and additions and improvements to existing transmission and distribution facilities. Although interest rates are expected to continue to gradually rise, Standard & Poor's expects debt financing to continue to accelerate as many companies build new power generating capacity, expand and improve transmission and distribution facilities, satisfy increasingly stringent environmental controls for coal-fired plants, and as merger and acquisition activity escalates.

↑back to top

Looking Ahead

The percentage of stable utility rating outlooks stood at 57% as of March 31, 2006, which closely mirrors the 58% recorded at the end of last year's first quarter. While negative outlooks declined considerably, negative CreditWatch placements have risen to nearly 17% from just 4% one year ago. The percentage of positive outlooks and positive CreditWatch listings were around 10% and 2%, respectively, at the end of the first quarter. This negative bias results mostly from:

- Deteriorating financial profiles,
- Weak competitive positioning,
- Investment in unregulated activities,
- Regulatory uncertainty,
- A volatile wholesale power market, and
- Acquisitions of financially weaker companies.

CreditWatch placements are typically driven by events such as mergers and acquisitions or the vulnerability of an issuer to a potentially unsupportive regulatory decision. Of all the companies on CreditWatch, 71% carry a negative listing, 20% are developing (which indicates that a rating may be raised, lowered, or affirmed), and 9% are positive.

Standard & Poor's continues to closely monitor the effects of higher energy costs and problems that could arise with fuel availability. Of primary importance to rating stability will be the level of support that state regulators provide to utilities for fuel cost recovery, particularly as gas and coal have risen exponentially.

Utilities with fixed-fuel clauses, frozen rates, or material regulatory lag face reduced operating margins, greater demand for working capital, or both. Companies that are routinely granted fuel true-ups may be required to spread recovery over many years to ease the pain for the consumer. However, not all companies suffer from high fuel costs. Companies with significant nuclear and coal base load capacity and midstream oil and gas operations are posting very good financial metrics.

In addition to fuel-cost recovery filings, regulatory commissions are addressing substantial rate base requests related to new construction and newly acquired generating capacity. Spending for environmental modifications on coal plants is accelerating, as are rate-setting requests for new transmission facilities. A very positive development for credit quality is the fact that many regulatory rulings related to the construction of new base load follow comprehensive settlement negotiations among utilities, commission staff, consumer advocates, and other major intervenors. Such an approach, which occurred in Wisconsin, Iowa, Missouri, Kansas, and Colorado, limits substantially the possibility of any subsequent review of utilities' expenditure decisions.

Despite the current industry emphasis on traditional utility operations, Standard & Poor's does not discount prospects for a return to business pursuits outside of the core competencies of utility management. Competition for capital and investor interest could again embolden companies to embrace growth strategies that would likely erode credit quality, absent protective structural and ring-fencing mechanisms. Efforts to reward shareholders through share repurchases or dividend increases are also a development that weighs on credit quality. These actions are especially significant for companies whose financial metrics are already subpar for their ratings, leaving them increasingly susceptible to negative rating actions.

↑back to top

Ratings Raised

Higher ratings for Allegheny Energy Inc. (BB+/Positive/B-2) and its subsidiaries are attributable to the strong likelihood that consolidated credit measures will improve substantially in 2006 and 2007 due to debt reduction and pricing of power that more closely reflects today's higher market rates. The ratings reflect the company's progress in restoring its much weakened credit profile after previous management's unsuccessful expansion into trading activities. Allegheny has sold most of its trading portfolio and less profitable businesses and now operates with considerably less debt. The company has made significant progress in overcoming many operational challenges, such as low tariffs and the rising cost of coal and emission credits, but some execution risk remains. The positive outlook reflects the expectation that Allegheny will continue to implement its plan to improve operations and reduce interest expense. An unexpected deterioration in operational performance has the most potential to cause an adverse rating action.

The ratings on Southern Star Central Corp. (BBB-/Stable/--) and subsidiary Southern Star Central Gas Pipeline Inc. were raised and removed from CreditWatch with developing implications where they were placed in connection with the company's sale to GE Energy Financial Services and Caisse de depot et placement du Quebec in August 2005. The action reflects an improved financial condition and continued strong business profile. Ratings stability reflects a predictable revenue stream, strong competitive position, healthy markets, and favorable regulation, somewhat offset by an intermediate financial profile.

The ratings on Northwest Natural Gas Co. (AA-/Stable/A-1+) were raised due to sustained strong financial performance even after it completed its substantial capital expenditure program. The excellent business profile of '1' reflects supportive regulation in Oregon, a conservative gas price hedging policy, a high-growth service area with a mostly residential customer base, and a reliable gas supply. Ratings stability reflects our expectation that Northwest Natural will maintain a financial performance consistent with benchmarks for the current rating and will finance additional capital investments so as to maintain a target 52%

ICNU Cross Exh. No.___
Docket No. UE-060266

equity layer.

The ratings on MidAmerican Energy Holdings Co. (MEHC; A-/Stable/--) were raised and removed from CreditWatch with positive implications. At the same time, Standard & Poor's affirmed its ratings on PacifiCorp (A/Stable/A-2) and removed them from CreditWatch with negative implications. These actions reflect the successful completion on March 26, 2006 of the acquisition of PacifiCorp by MEHC for about $5.1 billion in cash. PacifiCorp will account for about 35% of MEHC's operating income.

The ratings on MEHC and PacifiCorp reflect the consolidated company's creditworthiness and incorporate a strong business risk position, fairly aggressive financial profile, and both explicit and implicit support from MEHC's parent, Berkshire Hathaway Inc. (AAA/Stable/A-1+). Absent this support, MEHC's business and financial risk would support a rating in the 'BBB' category. The ratings on MEHC's parent-level debt consider the ring-fenced structure of MEHC's subsidiaries and MEHC's ability to meet parent-level financial obligations from dividend distributions from its portfolio of energy assets.

Berkshire Hathaway also provides a $3.5 billion equity commitment agreement, which in Standard & Poor's view would be called upon, if necessary, to support the rating on MEHC. The upgrade also reflects Berkshire Hathaway's increase in voting interest to 88% from 9.9% and its statements concerning a strategic focus on the regulated utility business. Furthermore, the higher rating on MEHC reflects steadily improving credit metrics and declining business risk with the incorporation of a more stable and geographically diverse operation.

MEHC has ring-fenced PacifiCorp to insulate it in the event that MEHC's consolidated creditworthiness deteriorates. As part of this structure, PacifiCorp will not pay dividends to MEHC from its cash flow unless it maintains a 48.25% common equity layer through 2008, gradually falling to 44% in 2012.

PacifiCorp's future challenges include a $6.4 billion capital program over the next five years, a sustained inability to earn its authorized rate of return, and pending and expected rate cases in the company's two largest markets, Utah and Oregon, where the company is seeking significant retail rate increases.

PacifiCorp's ratings and outlook reflect the expectation that credit metrics will improve, MEHC will fund its substantial near-term capital needs primarily with equity, and the company will achieve stronger returns on the newly invested capital. The rating also reflects the expectation of reasonable regulatory outcomes in several general rate cases.

The ratings on Northern Natural Gas Co. (A/Stable/-), a subsidiary of NNGC Acquisition LLC, which in turn is a wholly owned subsidiary of MEHC, were raised in conjunction with the upgrade on MEHC, and removed the rating from CreditWatch with positive implications, where they were placed on May 25, 2005. Northern Natural Gas' rating reflects an excellent business profile and strong stand-alone financial condition. The company has strong markets in the upper Midwest, limited alternative suppliers, and a highly contractual revenue base, with most revenues coming from investment-grade customers. Declining throughput, ongoing recontracting risk as firm transportation-service contracts expire, and competition for at-risk capacity temper these strengths. Because of a ring-fencing structure that protects Northern Natural Gas from credit events at MEHC, the rating on Northern Natural Gas is higher than that of MEHC, but it is still constrained to three notches from the parent. Ratings stability reflects that of parent MEHC, as well as regulatory support, expected stable operating performance, a lack of any significant near-term financing needs, and declining capital needs.

↑back to top

A Positive CreditWatch Listing

The ratings on United Waterworks (A-/Watch Pos/--) and United Water New Jersey were placed on CreditWatch with positive implications to reflect the improvement of parent Suez S.A.'s business and financial risk that would result from the pending merger with stronger, lower-risk Gaz de France (GDF). Standard & Poor's views GDF's business risk as lower than that of Suez due to the large share of earnings GDF derives from core regulated businesses in France. From a financial risk perspective, while Suez's financial profile is adequate, the company has weaker credit ratios than GDF and has announced an exceptional dividend of €1.25 billion to be paid out before the proposed merger. The proposed merger of GDF and Suez, if successful, will create a major leader in gas and, in particular, liquefied natural gas (LNG). GDF is a well-established LNG player in Europe, while Suez has strong positions in the U.S. Assuming all activities are retained, the enlarged group will also benefit from business diversification, with significant regulated segments offsetting the risks inherent in more competitive and cyclical businesses, such as energy services and Suez's international energy operations. The merger would be expected to generate initial pretax synergies of €500 million within three years, largely through the optimization of gas supply. The transaction requires a change in French law, which currently prevents the state's stake in GDF from falling below 70%. The ratings on GDF do not factor in state support, so a significant reduction of the French government's interest would not be a rating factor. Resolution of the CreditWatch will mainly be a function of evaluating the strategy and financial policies of the consolidated post-merger entity.

↑back to top

A New Positive Outlook

The outlook on Duke Energy Field Services LLC (DEFS; BBB/Positive/A-2) was revised to positive from stable to reflect the successful restructuring and modification of a portion of DEFS's gathering and processing contracts that partly mitigate, but do not eliminate, the margin volatility inherent in the gathering and processing industry. The outlook change also incorporates credit protection measures that have benefited materially from the improvement in natural gas and natural gas liquids prices.

↑back to top

Mixed CreditWatch Actions

The ratings on ONEOK Inc. (BBB/Watch Neg/A-2) and master limited partnership (MLP) Northern Border Partners L.P. (NBP; BBB+/Watch Neg/--) were placed on CreditWatch with negative implications, and the ratings of Northern Border Pipeline Co. (NBPL; BBB+/Watch Pos/--) were placed on CreditWatch with positive implications, following the announced transactions between ONEOK, NBP, and a unit of TransCanada PipeLines Ltd. (A-/Negative/--) that will alter the ownership and asset composition of all three entities. ONEOK will own all NBP's general partner (GP) and about 44% of the limited partnership units of NBP as a result of its purchase of TransCanada's roughly 20% share of the GP and the drop-down of $3 billion of ONEOK's midstream natural gas, liquids, and other assets. NBP will more than double in size by adding the ONEOK assets. The ownership of NBPL, now owned 70% by NBP, will be shared equally with a TransCanada affiliate. The negative CreditWatch listing for NBP is prompted by the greater business risk implied by the sale of part of its stake in NBPL and the addition of ONEOK's midstream assets, and the coming change in GP ownership to the lower-rated ONEOK. As the impending 100% owner of the GP of NBP, ONEOK joins the partnership on CreditWatch due to its transfer of a significant portion of its assets to the credit-constraining MLP structure and the stronger tie to the possibly weakening credit profile of NBP. ONEOK's decisions regarding the large cash proceeds from the asset drop-down will significantly influence the resolution of the CreditWatch listing. If the proceeds are mainly used to pay down debt, ONEOK's credit quality could be preserved. The planned ownership shift of NBPL could lead to a stand-alone rating, instead of being consolidated with the NBP ratings. NBPL's stronger business profile and credit-protection measures could result in higher ratings.

↑back to top

The Downgraded

The ratings on MDU Resources Group Inc. (BBB+/Stable/A-2) and subsidiaries including Montana-Dakota Utilities Co. were lowered as a result of Standard & Poor's assessment of MDU's business risk profile, which is increasingly reliant on the more volatile cash flow and earnings characteristics of its nonregulated subsidiaries. In particular, MDU's Fidelity Exploration & Production Co. represents nearly 50% of consolidated operating earnings, with regulated earnings only around 16%. As a result, MDU faces material risks from the volatile oil and natural gas industry, which directly affect cash flows and earnings.

Current market conditions are favorable and to some extent mitigate concerns about the business. However, in the longer term, operating performance is expected to show increased volatility through the respective business cycles that is not consistent with

Standard & Poor's expectations for an 'A-' rating.

↑back to top

Numerous New Negative CreditWatch Placements

The ratings on PEPCO Holdings Inc. (PHI; BBB+/Watch Neg/--) and its subsidiaries were placed on CreditWatch with negative implications. The short-term corporate credit and commercial paper ratings were not placed on CreditWatch. The CreditWatch listing reflects concerns over regulatory decisions for utility subsidiaries Delmarva Power & Light Co. (DPL) and Potomac Electric Power Co. (Pepco) that may hinder management's plan to improve financial metrics that are already weak for the current ratings. Standard & Poor's had expected material financial strengthening over the intermediate term, but such improvement may not occur for various reasons.

PHI, to minimize the effect on ratepayers of significantly higher power costs after the end of rate caps in mid-2006, has proposed in Delaware and Maryland a phase-in of increased power costs for DPL's and Pepco's standard offer service customers. DPL's proposal would result in an estimated $60 million of underrecovered of higher power costs by mid-2007 with subsequent recovery over two years. In Maryland, Pepco and DPL estimate that their underrecoveries could grow beyond $60 million and would require short-term borrowing of about $63 million to pay for the underrecovered power costs.

In Delaware, DPL filed its proposal after the governor ordered the Delaware Public Service Commission to report in March 2006 about actions that can be taken to minimize the expected power supply rate increases to DPL customers beginning May 1, 2006, when rate caps end. In Maryland, DPL and Pepco have filed settlements with the Maryland Public Service Commission that would result in accruals of underrecovered higher power costs through February 2007 with subsequent rate recovery through mid-2008.

The CreditWatch listing will be resolved when Standard & Poor's has assessed the full effect on PHI's credit quality from the various regulatory events.

The CreditWatch implications on KeySpan Corp. (A/Watch Neg/A-1) and its subsidiaries were revised to negative from developing. The action reflects KeySpan's agreement to be acquired by National Grid PLC (A-/Watch Neg/A-1) for $42 per share. Under the terms of the agreement, KeySpan is valued at about $7.3 billion, with an enterprise value of $11.8 billion. The CreditWatch listing indicates that the ratings may be affirmed or lowered depending on National Grid's acquisition financing structure and its effect on the consolidated financial profile and the combined company's business risk profile, which would be weaker than that of National Grid by itself. Assuming the deal is fully funded with cash, there is a strong likelihood that all ratings would be lowered by one notch.

The ratings on U.K.-based gas and electricity infrastructure company Natural Grid and its subsidiaries were earlier placed on CreditWatch with negative implications to reflect discussions concerning the potential KeySpan acquisition.

The ratings on Equitable Resources Inc. (A/Watch Neg/A-2) were placed on CreditWatch with negative implications after the company announced that it had reached a definitive agreement to acquire Dominion Resources Inc.'s natural gas distribution and midstream subsidiaries Dominion Peoples and Dominion Hope for a total of roughly $970 million. Although the acquisition is consistent with Equitable's strategy to increase gas distribution and midstream business in its core markets, the relatively high-priced and aggressive acquisition multiple (about 9x EBITDA), combined with uncertainties regarding the ultimate financial structure and operational implications of the transaction, raise Standard & Poor's concerns about Equitable's ability to support an 'A' rating profile. The negative CreditWatch listing incorporates the integration risk of the significant size and scope of the proposed transaction, combined with the undetermined use of debt issuance, equity, and asset sale proceeds to finance the proposed transaction and its ultimate effect on Equitable's overall creditworthiness. The Creditwatch will be resolved when Equitable receives the required approval from the appropriate regulatory commissions in Pennsylvania and West Virginia, which are expected by year-end 2006.

The ratings on Aquarion Co. (A/Watch Neg/--) and its subsidiaries were placed on

CreditWatch with negative implications following parent company U.K.-based Kelda Group PLC's proposed sale of the unit to Maquarie Bank Ltd. The transaction is valued at about $860 million. The resolution of the CreditWatch depends on more clarity regarding the financing structure of the transaction, Macquarie's intended business strategy, and regulatory approvals. A credit-conducive financing structure could support Aquarion's current rating level. However, a more aggressive financial structure could result in lower ratings. Completion of the regulatory process is expected to occur in the second half of 2006.

The ratings on Black Hills Corp. (BHC; BBB-/Watch Neg/--) and subsidiary Black Hills Power Inc. were placed on CreditWatch with negative implications after BHC decided to sign a confidentiality agreement with NorthWestern Corp. (NWEC; BB/Watch Dev/--) that paves the way for potential acquisition negotiations. The CreditWatch listing reflects the likelihood that a merger could materially weaken BHC's financial profile. NWEC is undertaking a strategic review of alternatives that may include selling the company to one of several bidders who have (according to NWEC) signed confidentiality agreements with the company. Standard & Poor's does not anticipate that BHC would pursue a hostile takeover. A merger with NWEC could weaken BHC's financial profile due to the potential use and assumption of incremental debt. BHC would assume the debt obligations of NWEC, which is highly leveraged with nearly $1.1 billion in total adjusted debt. Moreover, NWEC's cash flow protection measures are solidly speculative grade. Potential regulatory compromises as a condition for merger approval could also weaken BHC's financial profile. As a precondition for approval, Montana regulators may demand that BHC allocate some portion of anticipated merger savings to ratepayers, or they may force the company to agree to a rate freeze or rate reduction. Regulatory compromises would pressure the combined companies' ability to meet post-merger targets.

↑back to top

Recent Outlook Revisions To Negative

The outlook on IDACORP Inc. (BBB+/Negative/A-2) and main subsidiary Idaho Power Co. (IPC) was revised to negative from stable. IDACORP's 2005 results were slightly weaker, with prospective financial ratios at levels that are not sufficient to support the current rating. A ratings cut could occur if IPC cannot achieve its projected financial metrics. Possible cost pressures include the inability to recover, or a significant delay in the recovery of, substantial costs arising from the passage of Idaho House Bill 800 (which has subsequently been defeated) or other similar water-diversion legislation, a substantial tax liability from the prior simplified service cost method-related cash tax refunds, or other negative circumstances.

The outlook on Portland General Electric Co. (PGE; BBB+/Negative/--) was revised to negative from stable owing to a somewhat weak financial profile, compounded by an accumulation of numerous other concerns that could negatively affect both the financial and business positions over the next few years. These issues include uncertain additional costs resulting from the outage at the 565 MW coal-fired Boardman plant, risks from hydro variations that cannot currently be passed through to customers, contingent financial exposure related to litigation surrounding PGE's right to earn a return on its Trojan investment, and the City of Portland's ongoing attempts to investigate PGE's taxes and trading practices.

The outlook on Peoples Energy Corp. (A-/Negative/A-2) and its subsidiaries was revised to negative from stable owing to regulatory uncertainties. The regulatory climate in Illinois has become highly politicized, pressuring the settlement agreement related to the utilities' 2000-2004 gas-purchase proceedings and expected rate case filings. If the company faces further challenges regarding its gas-purchase prudence reviews or cannot restore its balance sheet with equity issuances, asset sales, or both within a year, the ratings may be lowered. Incremental pressure could result from disproportionate growth from diversified businesses.

The outlook on PNM Resources Inc. (PNMR; BBB/Negative/A-3) and subsidiaries Public Service Co. of New Mexico (PNM) and Texas-New Mexico Power Co. was revised to negative from stable owing to recent financial erosion resulting from decreased availability of the Palo Verde nuclear station, the cost of replacement power, and accelerating construction outlays. Palo Verde outages affect PNMR because the company has no fuel clause or other cost pass-through mechanisms. Given these operational concerns, the financial profile may weaken in 2006-2007 as a result of PNMR's acquisition from Sempra Energy for $480 million of the 305 MW circulating fluidized-bed Twin Oaks generating plant south of Waco, Texas. The company stated that it will structure the financing to maintain its investment-grade rating.

The outlook on Buckeye Partners L.P. (BBB+/Negative/-) was revised to negative from stable following the company's announcement to acquire a natural gas liquids (NGL) pipeline and two refined product terminals for $120 million. While these acquisitions are smaller than the two previous acquisitions, Standard & Poor's concern about management's aggressive growth strategy continues, especially since the performance of assets acquired from Exxon Mobil Corp. lags expectations. Another concern raised by the most recent acquisition is the entry into NGL pipelines, a riskier business segment relative to Buckeye Partners' traditional refined pipeline business.

↑back to top

Recent Ratings Stability

The outlook on Tucson Electric Power Co. (TEP; BB/Stable/--), a subsidiary of unrated UniSource Energy, was revised to stable from negative due to the expectation that stagnant consolidated cash flow metrics over the past two years resulted from one-time events and that future credit metrics will improve. The company's continued commitment to deleveraging the consolidated capital structure is critical in order to sustain TEP's ratings. Ratings stability also assumes that regulatory rate proceedings, which have been prolonged and contentious regarding another Arizona utility, will continue to support credit quality. An unfavorable resolution of TEP's ratemaking treatment after the end of its rate cap in 2009 could result in a lowering of the ratings or a negative outlook.

The outlook on Alliant Energy Corp. (BBB+/Stable/A-2) and subsidiaries was revised to stable from negative owing to Standard & Poor's expectations that the company is now better positioned to maintain consolidated financial metrics commensurate with the current rating. The outlook on the company had been negative since 2002 as a result of the company's inability to meet financial targets associated with several of its higher-risk, nonregulated businesses. Having refocused its efforts on its core utility businesses, Alliant has enhanced the future stability of the company's cash flows. By paying down nearly $1 billion in debt, Alliant has also kept permanent balance sheet deterioration at bay. While Alliant still has meaningful deleveraging to accomplish over the next year (underperforming, nonregulated Alliant Energy Resources Inc. accounted for about 40% of consolidated gross debt outstanding as of September 2005), debt reduction is predicated on asset sales and certain asset monetizations that, in Standard & Poor's estimation, have either already occurred (in the fourth quarter of 2005) or are reasonably likely to occur before the end of 2006. Potential asset sales include the company's portfolio of cogeneration interests in China, its U.S. pipeline investments, and, to a lesser degree, its Mexico investment. Asset monetizations include the use of nonrecourse debt at the company's New Zealand projects and the subsequent repatriation of proceeds as a source of cash for debt reduction in the U.S.

↑back to top

Ratings Affirmations And CreditWatch Removals

The ratings on CMS Energy Corp. (BB/Stable/B-1) and subsidiary Consumers Energy Co. were affirmed and removed from CreditWatch with negative implications. The rating actions incorporate CMS Energy's continued focus on core utility operations, satisfactory regulatory environment, predictable regulated cash flow, sufficient liquidity, limited near-term debt maturities, and the expected continuation of parent-level debt reduction. The stable outlook is also contingent on CMS Energy's ability to meet increased capital expenditures and near-term working capital needs primarily with internally generated cash flow while maintaining appropriate liquidity and continuing to strengthen its overall financial profile to levels that are more commensurate with the current ratings.

CMS is nearing the end of a lengthy process of selling a significant portion of its nonregulated business lines, using proceeds mainly to reduce debt. When all asset sales are complete, Standard & Poor's expects regulated electric and gas utility Consumers Energy to contribute more than 80% of consolidated cash flow.

The ratings on Southern Union Co. (BBB/Negative/--) were affirmed and removed from CreditWatch with negative implications. The outlook remains negative. These actions followed a review of the company's plans to acquire Sid Richardson Energy Services (SRES), a privately held gas gathering and processing business in the Texas Panhandle, for $1.6 billion.

RES owns highly efficient gas-processing and -treating plants, and in its operating territory is the second-largest gathering and processing operator on the Texas side and third largest on the New Mexico side of the border. Southern Union's 50%-owned Transwestern Pipeline Co LLC is one of the major gas pipelines out of the Permian Basin region, where SRES has operated for more than 60 years.

With this acquisition, Southern Union moves further away from natural gas utilities and toward gas transportation and services industry. As a result, the company's credit quality may become less stable and predictable, a situation that will be dictated by future acquisitions and by related financing structures.

The ratings on WPS Resources Corp. (A/Negative/A-1) and subsidiary Wisconsin Public Service Corp. (A+/Negative/A-1) were affirmed and removed from CreditWatch with negative implications following an assessment of the qualitative and financial effects of acquiring two gas distribution utilities for about $558 million. Consolidated financial measures will remain weak for the rating, but are expected to improve substantially in 2006 due to the full realization of recent rate relief and after one-time tax payments related to the Kewaunee nuclear plant sale are completed. WPS Resources has multiple events that must be successfully completed before the company's performance can be considered stable. The gas utilities should successfully be integrated into the corporate family and meet Standard & Poor's expectations for contributions to consolidated FFO. The acquisition is expected to be financed in a manner that is consistent with current ratings.

The ratings on Empire District Electric Co. (BBB/Negative/A-2) were affirmed and removed from CreditWatch with negative implications following a review of the acquisition of a gas distribution utility in Missouri for $84 million. Empire faces multiple uncertainties: integration of the gas utility into the existing corporate family; financial measures are very weak for the current ratings; and a heavy construction program that depends critically on supportive rate actions. Timely recovery of fuel and power costs is also important for Empire's credit quality because it operates a relatively high level of gas-fired generation. Empire recently filed for about a $30 million rate increase and the enactment of an Energy Cost Recovery rider that, if authorized, should strengthen the company's financial profile by 2007.

↑back to top

FitchRatings

Corporate Finance

Global Power/North America
Special Report

U.S. Power and Gas 2006 Outlook

Analysts
Glen Grabelsky
+1 212 908-0577
glen.grabelsky@fitchratings.com

Sharon E. Bonelli
+1 212 908-0581
sharon.bonelli@fitchratings.com

Robert Hornick
+1 212 908-0523
robert.hornick@fitchratings.com

Ellen Lapson
+1 212 908-0504
ellen.lapson@fitchratings.com

Ralph G. Pellecchia
+1 212 908-0586
ralph.pellecchia@fitchratings.com

Karl H. Pfeil
+1 212 908-0516
karl.pfeil@fitchratings.com

Alan Spen
+1 212 908-0594
alan.spen@fitchratings.com

Hugh F. Welton
+1 212 908-0746
hugh.welton@fitchratings.com

Contents

Overview

At the current stage in the industry cycle, a number of factors call for increased investor caution toward the power and gas sector.

The credit recovery that has been in progress for three years since the credit meltdown of the power and gas sector in late 2002 appears to have run its course. Most companies in the sector that suffered credit deterioration have repaired their balance sheets or are far along in that process. Entities that improved their credit ratings generally did so by withdrawing from their most speculative business activities, reducing debt and returning their focus to lower risk strategies in their core business. The happy combination of low interest rates and easily accessible bank and bond markets enabled both investment-grade and speculative-grade entities to extend their near-term debt maturities, lower interest expense and improve liquidity by arranging multiyear bank credit facilities. Overleveraged companies sold assets, simplified their capital structures and, in some cases, issued equity securities during the 2004–2005 period.

The current outlook is dominated by high and volatile energy commodity prices combined with an upturn in regulatory risk, increasing capital spending and the resultant dependence on external funding, and the potential return to more aggressive corporate and financial strategies.

Commodity Prices and Regulatory Risk

First and foremost, unusually high and volatile natural gas and energy prices raise risk overall. Higher commodity prices will affect most companies throughout the sector, positively for some companies with favorable energy positions but unfavorably for many others. Nearly all companies in the sector will experience greater working capital needs for receivables, inventories and collateral. Further moves up or down in natural gas prices may have profound implications for companies, as discussed in the outlooks for the various segments within the broad sector.

For gas and electric utilities, high energy prices, combined with rising capital spending and higher nonfuel operating expenses, will make individual utilities dependent on multiple rate increases and/or energy-adjustment tariffs to recover their higher costs, thus creating more political and regulatory risk. Also, consumers are likely to reduce their consumption in response to materially higher gas and electricity prices, which could trigger a cycle where utilities have to request additional tariff increases in order to recover their fixed costs. Utilities that fail to recover their full costs from consumers will experience lower cash flows and profits, increased debt leverage and weaker credit metrics. Volatile and high energy prices can have unfavorable consequences for

The Credit Outlook Summary by Segment table on page 6 summarizes Fitch's credit outlooks for the segments based on a top-down analysis of economic forces. While industrywide factors call for greater caution on the part of investors, individual Rating Outlooks of entities in the sector will be driven more by their particular circumstances than by uniform industry factors. Entities operating in constructive regulatory environments or insulated from commodity price swings through diversified resources or favorable hedging contracts are best situated to weather volatile commodity markets.

Key Factors in the 2006 Outlook

Many leading elements forming the foundation for the U.S. Power and Gas 2006 Outlook were present in the 2004 and 2005 reports. However, the following represent important changes or new elements:

- Fitch previously viewed the state regulatory environment as particularly favorable to the financial health of regulated electric and gas utilities in the 2004 and 2005 reports. While still generally favorable, currently, Fitch sees increased event risk related to state regulatory and political reactions to rising energy prices. Companies subject to disproportionate increases in costs and in greatest need of tariff increases are most at risk. Sooner or later, resistance to full recovery of utilities' rising costs could result in unfavorable rate decisions, which would erode profit margins and weaken utility cash flow. Distributors of gas and electricity are likely to experience these effects sooner, over the next 6–24 months, while integrated electric utilities may experience these effects either in the near term or more gradually over the five-year horizon.
- Substantial utility tariff increases over the next several years may result in reduced sales volume and demand destruction. Slower growth or actual decline in sales makes it more difficult for utilities to recover their fixed costs and contributes to the unfavorable trend of rising costs per unit of sales.
- In the 2005 Outlook, Fitch foresaw continuing open capital market access for the sector for the year 2005. Although there is no indication of any change to date in the sector's access to funding, the capital markets climate could turn less favorable if individual companies or groups of companies are adversely affected by rising costs, unfavorable regulatory and legislative policies, or losses due to volatile wholesale commodity markets. Also, a rise in interest rates would reduce the financial markets' appetite for securities of capital intensive companies, such as utilities, pipelines and power generators. However, the demonstrated ability of power and gas companies to obtain new funding to stave off bankruptcy even at the nadir of the 2002–2003 credit crisis evidences the market's willingness to continue to provide funding to most of the sector at some price.

A number of elements that influenced the 2005 Outlook remain substantial factors in the 2006 Outlook.

- Gas prices have increased to high levels as a result of supply disruption due to storm damage to producing centers in the Gulf of Mexico and the depletion of the gas bubble. In Fitch's view, gas prices will remain at a relatively high level over the coming five years, reflecting difficulties in developing new domestic supply sources, steeper decline rates of existing resources, global competition and limited liquefaction and shipping capacity for liquefied natural gas (LNG), and projected rising consumption for electric generation. However, the gas price environment remains extremely volatile and subject to fluctuations, down as well as up, both in the near term and longer term. For modeling purposes, Fitch uses three gas price assumptions. The Natural Gas Price at Henry Hub table on page 4 indicates the three cases and compares them to the New York Mercantile Exchange (NYMEX) forward strip as of Dec. 5, 2005.
- Longer term, spot and forward electricity prices in many U.S. power regions are increasingly determined by natural gas prices, since natural gas-fueled power generation is on the margin and setting the price in many regional markets.
- High gas prices generally favor companies that own oil, gas or coal reserves, and generation facilities fueled by coal or uranium. However, gas price volatility is also a source of considerable risk for these companies. In particular, nonutility power generators with coal or nuclear generation may be subject to some event risk due to unpredictable political or legislative pressures in response to higher market prices of power or changes in environmental emissions standards.
- Gas transmission pipelines and gas midstream companies generally will be less vulnerable to

higher interest rates are likely to adversely affect equity prices in this sector, increase pressure for higher dividends and reduce the ease of funding the expected rise in capital expenditures through retention of earnings or new equity issuance.

- Fitch views rapid consolidation as more likely to occur among competitive generation and wholesale energy marketing companies than for state-regulated electric and gas utilities. The repeal of the Public Utility Holding Company Act of 1935 (PUHCA) as a result of the passage of the Energy Policy Act of 2005 removes one barrier to consolidation among regulated utilities, but PUHCA was not an insurmountable barrier to mergers. In Fitch's view, industry consolidation of state-regulated investor-owned utilities is still limited by state and local opposition, onerous preconditions imposed by state regulators and Federal Energy Regulatory Commission (FERC) restrictions on market power. Also, FERC's implementation rules for the new PUHCA of 2005 remain to be determined and in the near-term will be an uncertain element. That being the case, corporate merger activity in the sector has been at such a low level over the past four years that, in Fitch's view, increased M&A activity is a reasonable expectation.

Utility Parent Companies and Groups

The utility sector was the darling of Wall Street for most of 2005. However, the sector may find less favor with investors in the coming year, as the political and regulatory environments become more uncertain, volatile wholesale energy markets add to risk and interest rates begin to incorporate higher inflation.

The turnaround and recovery of many utility groups that began in 2002 is now largely complete. Unprofitable diversified operations have, for the most part, been sold or shuttered, and balance sheets have strengthened. In addition, for companies that remain in the merchant generation and trading businesses, the risk tolerance level has been substantially reduced. The majority of parent holding companies are now dominated by core utility businesses that can be expected to provide relatively lower earnings growth, intensifying pressure on management to increase shareholder returns through less creditor-friendly activities, such as more aggressive share repurchase activity, a continuation of dividend increases, debt-financed utility acquisitions or an expansion of nonutility investments. A number of utility groups jumped onto the "back to basics" bandwagon or never strayed far from their core utility focus. Others, such as Sempra Energy, Dominion Resources, Inc., Constellation Energy Group (Constellation Energy), MDU Resources Group, Inc., TXU Energy Co. LLC, etc., are following a more diversified strategy.

Dividend increases were a popular way for utility groups to return cash to shareholders during 2005, and Fitch believes this trend is likely to persist. Cash common dividend payments grew 16.8% to $11.5 billion during the first nine months of 2005, as a result of dividend increases and/or a higher number of shares outstanding. Companies that paid at least 20% more in dividends in the first nine months of 2005 compared with the same period of 2004 included Constellation Energy, DPL Inc., Edison International, Exelon Corp., PNM Resources, Sempra Energy, TXU Corp. (TXU) and Westar Energy. It should be noted that Fitch does not necessarily consider dividend increases targeted to reach the industry average payout ratio to necessarily be negative for credit quality, particularly if it signals a more conservative business strategy and maintains access to equity capital. However, dividend increases can be more problematic in periods of rising

Utility Parent Companies

	Rating*	Rating Outlook	IDR
Above Segment Median Rating			
WGL Holdings, Inc.**	'A+'	Stable	'A+'
Consolidated Edison, Inc. (Con Ed)	'A'	Stable	'A'
FPL Group, Inc.	'A'	Stable	'A'
MDU Resources Group, Inc.	'A'	Stable	'A–'
Nicor Inc.**	'A'	Stable	'A'
NSTAR	'A'	Stable	'A–'
OGE Energy Corp.	'A'	Stable	'A'
Peoples Energy Corp.	'A'	Stable	'A'
Sempra Energy	'A'	Stable	'A'
Southern Company	'A'	Stable	'A'
AGL Capital Corp.	'A–'	Stable	'A–'
AGL Resources, Inc.	'A–'	Stable	'A–'
Ameren Corp.	'A–'	Stable	'A–'
Centennial Energy Holdings, Inc.	'A–'	Stable	'A–'
Constellation Energy Group	'A–'	Stable	'A–'
KeySpan Corp.	'A–'	Positive	'A–'
National Fuel Gas Co.	'A–'	Stable	'A–'
SCANA Corporation	'A–'	Stable	'A–'
Wisconsin Energy Corp.	'A–'	Stable	'A–'
CILCORP, Inc.	'BBB+'	Stable	'BBB+'
Dominion Resources, Inc.	'BBB+'	Stable	'BBB+'
Duke Energy Corp.	'BBB+'	Stable	'BBB+'
Exelon Corp.	'BBB+'	Stable	'BBB+'
Xcel Energy Inc.	'BBB+'	Stable	'BBB'
At Segment Median Rating			
American Electric Power Co., Inc.	'BBB'	Stable	'BBB'
Cinergy Corp.	'BBB'	Stable	'BBB'
DTE Energy Co.	'BBB'	Stable	'BBB'
Energy East Corp.	'BBB'	Stable	'BBB'
Entergy Corp.	'BBB'	Negative	'BBB–'
IDACORP, Inc.	'BBB'	Stable	'BBB'
MidAmerican Energy Holdings Co.	'BBB'	Stable	'BBB'
MidAmerican Funding LLC**	'BBB'	Stable	'BBB'
NiSource Capital Markets, Inc.	'BBB'	Stable	'BBB'
NiSource Finance Corp.	'BBB'	Stable	'BBB'
NiSource Inc.	'BBB'	Stable	'BBB'
Northeast Utilities	'BBB'	Negative	'BBB'
PEPCO Holdings, Inc.	'BBB'	Negative	'BBB'
Pinnacle West Capital Corp.	'BBB'	Stable	'BBB'
PPL Corporation	'BBB'	Stable	'BBB'
Public Service Enterprise Group Incorporated	'BBB'	Positive	'BBB'
Below Segment Median Rating			
CenterPoint Energy, Inc.	'BBB–'	Stable	'BBB–'
DPL Inc.	'BBB–'	Stable	'BBB–'
Duke Capital, LLC	'BBB–'	Stable	'BBB–'
Duquesne Light Holdings, Inc. (formerly known as DQE, Inc.)	'BBB–'	Stable	'BBB–'
FirstEnergy Corp.	'BBB–'	Stable	'BBB–'
IPALCO Enterprises, Inc.	'BBB–'	Stable	'BBB–'
PanEnergy Corp.	'BBB–'	Stable	'BBB–'
PNM Resources	'BBB–'	Stable	'BBB–'
Progress Energy Inc.	'BBB–'	Stable	'BBB–'
TXU Corp.	'BBB–'	Negative	'BBB–'
Avista Corp.	'BB+'	Stable	'BB'
TECO Energy, Inc.	'BB+'	Stable	'BB+'
Edison International	'BB'	Stable	'BB'
Allegheny Energy, Inc.	'BB–'	Positive	'BB–'
CMS Energy Corp.	'BB–'	Stable	'B+'
Sierra Pacific Resources	'B+'	Stable	'B+'

*Senior unsecured. **Indicative rating. IDR – Issuer default rating.
Note: Median ratings based on senior unsecured debt. Note: Calculation of median ratings has changed from previous years.
Source: Fitch Ratings.

and pipeline facilities, LNG landing facilities, power transmission, nuclear power plants and alternative electricity sources, while reducing the potentially adverse effect of capital spending on credit quality of affected companies. Most of these opportunities will have effect in the longer term rather than in the next 12–24 months.

A more immediate change resulting from EPACT 2005 is the replacement of PUHCA, with new provisions called PUHCA 2005, set to occur in February 2006. In Fitch's view, state public utility commissions or FERC will likely exert more active regulation in areas formerly regulated under PUHCA following the PUHCA 1935 repeal. More industry consolidation could also result from PUHCA 2005, perhaps of geographically disparate utility systems or electric and gas systems. However, state regulatory public service commission (PSC) denials, onerous preconditions for merger approvals and the new FERC scrutiny of proposed transactions involving generation facilities used for interstate sales of power will continue to restrain rampant consolidation.

needs. Utility cash flows could also be adversely affected by slower customer payments and temporary reductions in demand, as customers experience difficulty in coping with higher energy bills. Another possible adverse outcome for utilities is demand destruction that would require a utility to raise prices even more to recover fixed costs over a smaller volume of sales. In other cases, in jurisdictions that do not permit full or timely cost recovery, utilities will experience lower profit margins, increased leverage and weaker credit metrics.

Fitch also notes that gas distribution companies have substantial seasonal borrowing needs for gas storage and are particularly susceptible to lags in cost recovery and rising short-term interest rates.

Not all companies will be adversely affected by the less favorable operating environment. In fact, the ratings of the handful of utilities owned by speculative-grade parent companies may improve as a result of the continuing credit recovery of parent companies that are reducing debt and lowering business risk in order to restore investment-grade ratings. Vertically integrated electric utilities that rely on nuclear or coal-fired generating resources to meet the bulk of their power supply obligations or pure distribution companies with no supply obligations should experience more modest cost pressures. However, even integrated utilities with little or no gas exposure face rising prices for coal and emission credits and increased capital spending to meet environmental standards and new capacity needs over the next five years. The event risk associated with an extended nuclear or coal plant's forced outage is also magnified in the current high gas cost environment.

Regulatory adjustment mechanisms can provide a buffer to rising costs, as was recently demonstrated in Florida, where each of the state's electric utilities was able to recover significant fuel cost increases and substantial 2004 storm cost recovery. However, Fitch is concerned that continued applications for base rate increases and higher fuel or purchased gas recovery factors could result in regulatory fatigue and less favorable rate treatment.

Over the next five years, Fitch expects that natural gas prices will eventually recede to levels below the current forward price curve. However, integrated electric utility operating companies will continue to face higher costs for environmental compliance and growing capital spending for resource adequacy, requiring ongoing regulatory support. Moreover, in

Utility Distribution Companies

	Rating*	Rating Outlook	IDR
Above Segment Median Rating			
Boston Edison Co.	'AA–'	Stable	'A+'
San Diego Gas & Electric Co.	'AA–'	Stable	'A+'
Southern California Gas Co.	'AA–'	Stable	'A+'
Washington Gas Light Co.	'AA–'	Stable	'A+'
Brooklyn Union Gas Co.	'A+'	Stable	'A'
Consolidated Edison Co. of New York, Inc. — Con Ed	'A+'	Stable	'A'
Nicor Gas Company**	'A+'	Stable	'A'
North Shore Gas Co.**	'A+'	Stable	'A'
Orange & Rockland Utilities, Inc.	'A+'	Stable	'A'
Peoples Gas Light & Coke Co.**	'A+'	Stable	'A'
Rockland Electric Company**	'A+'	Stable	'A'
Wisconsin Gas Co. LLC	'A+'	Stable	'A'
Laclede Gas Co.	'A'	Stable	'A'
Northwest Natural Gas Company	'A'	Stable	'A'
American Transmission Co. LLC	'A'	Positive	'A–'
Atlanta Gas Light Co.	'A'	Stable	'A–'
Baltimore Gas and Electric Company	'A'	Stable	'A–'
Cambridge Electric Light Company	'A'	Stable	'A–'
Central Hudson Gas & Electric Corp.	'A'	Stable	'A–'
Commonwealth Electric Company	'A'	Stable	'A–'
KeySpan Gas East Corp.	'A'	Positive	'A–'
At Segment Median Rating			
NSTAR Gas**	'A–'	Stable	'A–'
AmerenCIPS	'A–'	Stable	'BBB+'
Central Maine Power Co.	'A–'	Stable	'BBB+'
Connecticut Natural Gas Corp.	'A–'	Stable	'BBB+'
Delmarva Power & Light Company	'A–'	Negative	'BBB+'
PECO Energy Co.	'A–'	Stable	'BBB+'
Potomac Electric Power Co.	'A–'	Negative	'BBB+'
Public Service Electric & Gas Co.	'A–'	Stable	'BBB+'
Southern Connecticut Gas Co.**	'A–'	Stable	'BBB+'
Below Segment Median Rating			
Atlantic City Electric Company	'BBB+'	Stable	'BBB'
Connecticut Light & Power Co.	'BBB+'	Negative	'BBB'
Michigan Consolidated Gas Co.**	'BBB+'	Stable	'BBB'
New York State Electric & Gas Corp.	'BBB+'	Stable	'BBB'
PPL Electric Utilities Corporation	'BBB+'	Stable	'BBB'
TXU Electric Delivery Company	'BBB+'	Stable	'BBB'
Union Light, Heat & Power Company	'BBB+'	Stable	'BBB'
Western Massachusetts Electric Co.	'BBB+'	Stable	'BBB'
Atmos Energy Corp.	'BBB+'	Negative	'BBB+'
Commonwealth Edison Co.	'BBB+'	Stable	'BBB+'
Consolidated Natural Gas Co.	'BBB+'	Stable	'BBB+'
CenterPoint Energy Houston Electric, LLC	'BBB'	Stable	'BBB'
Southern Union Co.	'BBB'	Stable	'BBB'
Southwest Gas Corporation	'BBB'	Stable	'BBB'
Jersey Central Power & Light Company**	'BBB'	Stable	'BBB–'
Metropolitan Edison Company	'BBB'	Stable	'BBB–'
Pennsylvania Electric Company	'BBB'	Stable	'BBB–'
Pennsylvania Power Company**	'BBB'	Stable	'BBB–'
Rochester Gas & Electric Corporation	'BBB'	Stable	'BBB–'
Texas New Mexico Power Company	'BBB'	Stable	'BBB–'
Central Vermont Public Service Corp.	'BBB–'	Stable	'BB+'
Illinois Power Co.	'BBB–'	Stable	'BB+'
Duquesne Light Co.	'BBB–'	Positive	'BBB–'
Potomac Edison Co.	'BBB–'	Stable	'BBB–'
West Penn Power Co.	'BBB–'	Stable	'BBB–'

*Senior unsecured. **Indicative rating. IDR – Issuer default rating. Note: Median ratings based on senior unsecured debt. Note: Calculation of median ratings has changed from previous years.
Source: Fitch Ratings.

Diversified Energy Merchants

Fitch's diversified energy merchant segment includes a variety of entities, including independent power producers (IPPs) and other diversified energy companies with a substantial stake in the power sector as well as wholesale generation companies that are affiliated in a utility holding company group. Within the IPP/diversified group, the majority of companies bear noninvestment-grade ratings with a median issuer default rating (IDR) of 'B+', while the median rating for the affiliated generation companies is 'BBB'. The credit outlook for the IPP/energy merchant group has recently shifted to stable from positive, largely reflecting the expectation that ongoing deleveraging efforts will take longer than anticipated in Fitch's 2005 Outlook. In particular, higher gas prices will continue to force these companies to redirect cash on hand and proceeds from recent asset sales toward expanded margin requirements as opposed to permanent debt reduction. At the same time, companies with natural gas production assets, commodity-based midstream activities or significant coal-fired capacity will continue to experience above-average margins in the current gas price environment but could also demonstrate an inclination to invest more in acquisitions, growth projects or other shareholder-oriented ends rather than debt reduction.

The stable credit outlook also reflects the fact that many of the "self-help" initiatives carried out by the distressed energy merchants over the 2003–2005 period have essentially concluded. Noncore asset sales have been wrapped up and debt has been or will be paid down. Accordingly, at this juncture, future reduction in leverage measures and ratings improvement will depend largely on a sustained recovery in merchant power markets and the deployment of free cash flow toward debt reduction.

The near-term credit outlook for affiliated wholesale generating companies remains stable. This group has generally maintained a balanced capital structure that is consistent with investment-grade ratings and, in most cases, benefits from more predictable cash flows from contracts with affiliated distribution utilities. These companies are also more likely to own generating portfolios that are largely coal- and nuclear-fueled and less dependent on natural gas. However, similar to the IPP/merchant group, these companies also face rising collateral requirements relating to higher natural gas costs and, in some cases, supply contracts that are well-below current market prices.

Diversified Energy and Unregulated Companies

	Rating*	Rating Outlook	IDR
Above Segment Median Rating			
PPL Energy Supply, LLC	'BBB+'	Stable	'BBB'
Ameren Energy Generating Co.	'BBB+'	Stable	'BBB+'
Exelon Generation Co. LLC	'BBB+'	Stable	'BBB+'
Southern Power Co.	'BBB+'	Stable	'BBB+'
PSEG Power LLC	'BBB'	Positive	'BBB'
TXU Energy Co. LLC	'BBB'	Negative	'BBB'
System Energy Resources Inc.**	'BBB–'	Negative	'BBB–'
At Segment Median Rating			
Allegheny Generating Co.	'BB+'	Positive	'B+'
Mirant Mid-Atlantic LLC†	'BB+'	Stable	'B+'
Below Segment Median Rating			
AES Corporation	'BB'	Stable	'B+'
PSEG Energy Holdings LLC	'BB'	Negative	'BB+'
Allegheny Energy Supply Co., LLC	'BB–'	Positive	'B+'
Mirant North America, LLC†	'BB–'	Stable	'B+'
Midwest Generation LLC‡	'B+'	Stable	'B'
Reliant Energy, Inc.**	'B+'	Stable	'B+'
Mirant Americas Generation, LLC†	'B'	Stable	'B+'
Edison Mission Energy	'B'	Stable	'B'
Mission Energy Holding Co.**	'B–'	Stable	'B'
Dynegy Holdings Inc.	'CCC+'	Stable	'B–'
Calpine Corp.	'CC'	Negative	'CC'

*Senior unsecured. **Indicative rating. †Expected rating upon reorganization. ‡Second-lien notes. IDR – Issuer default rating. Note: Median ratings based on senior unsecured debt. Note: Calculation of median ratings has changed from previous years. Source: Fitch Ratings.

While there is some risk that lower gas prices will reduce profit margin, the exposure is mitigated by the high percentage of contractual revenue.

Within the span of Fitch's short-term outlook, which covers a 12–24 month period, sector consolidation will likely accelerate. The process was kicked off with the October 2005 merger agreement struck between Texas Genco Holdings Inc. (TGN) and NRG Energy, Inc. (NRG). In addition, both Reliant Resources, Inc. (RRI) and Dynegy Inc. (DYN) have spoken publicly regarding their desire to achieve great operating scale and cost benefits through strategic combinations. Both RRI and DYN have been actively selling off noncore assets in an effort to further repair their balance sheets ahead of planned consolidation activities. Moreover, Mirant Corporation (Mirant) will soon emerge from Chapter 11 and should be considered an attractive M&A candidate with its restructured balance sheet, narrowed business focus and attractive mix of low-cost coal generating assets located in the mid-Atlantic region. Given the current rating levels of the likely merger candidates (i.e., IDRs in the 'B' range), Fitch does not believe that such prospects necessarily elevate risk. In other words, the ultimate effect on credit quality could be neutral to

Natural Gas Pipelines and Midstream

Natural Gas Pipelines

The credit outlook for natural gas pipelines is stable for both the 12- to 24-month and five-year time frames. On balance, pipelines operate evenly through business cycles, generate stable cash flows and have limited or manageable exposure to commodity prices. Despite high and volatile natural gas prices and extreme weather swings, operating performance and financial credit measures have remained extremely consistent for the pipeline sector over the past several years. This has been the case for both corporate and master limited partnership (MLP)-owned pipelines.

Interstate pipelines have demonstrated a limited sensitivity to external factors due to their primary role as transporters of natural gas and the fixed-payment obligation of shippers under volume-insensitive FERC-regulated rates. Intrastate systems tend to operate with a wider variation of contract structures, under which revenues may be volume-sensitive. However, in the Texas/Louisiana area, where many intrastate systems are located, near-term operating conditions are mostly favorable despite local infrastructure damage and supply disruptions caused by Hurricanes Katrina and Rita. While Fitch anticipates some nationwide demand reduction over the coming year as the result of high natural gas prices, Fitch does not expect any material financial effect for pipelines.

Most long-term energy forecasts indicate increasing domestic consumption of natural gas, primarily driven by increased use for power generation. This is the case even though future growth in demand is likely to be moderated by increasing investment in new coal-fired and nuclear generating facilities. Until an Alaskan pipeline is built possibly in the 2014–2016 time frame, the expected supply/demand imbalance is expected to be met, in part, with increased utilization of imported LNG. The likely siting for much of the development will take place in the Gulf Coast area and should be favorable in maintaining volume on the nearby pipelines, sourcing natural gas from or transporting locally through this region beginning 4–5 years from now. However, if a large marine facility or two is built on the East or West Coasts near large end-user markets, pipelines serving those regions may experience competitive pressure and have difficulty recontracting. Fitch believes the pipelines that have the greatest exposure to LNG competition in five years are those serving southern California (i.e., El Paso Natural Gas Company and Transwestern Pipeline Company).

While operating fundamentals are stable, the sector is far from stagnant. Fitch has observed heightened acquisition activity and a rapid increase in asset valuations across the energy spectrum, including pipelines. This trend continued throughout 2005. In some cases, buyers justify high purchase multiples and acquisition debt on assumed future cost reductions and/or planned earnings enhancements. However, actual operating results may lag pro forma expectations. Furthermore, investment by nontraditional financial players, including private-equity groups, has expanded. Such investors have been particularly active in MLP investments through acquisition of controlling general partner interests. A potential concern is that financial investors' shorter investment horizon and profit targets will encourage overly aggressive operating and financial strategies, including increasing holding company and operating

Natural Gas Pipeline and Midstream Companies

	Rating*	Rating Outlook	IDR
Above Segment Median Rating			
Kern River Funding Corp.	'A–'	Stable	'A–'
LOOP LLC	'A–'	Stable	'A–'
Northern Border Pipeline Company	'A–'	Stable	'A–'
Northern Natural Gas Company	'A–'	Stable	'A–'
Kinder Morgan Energy Partners, LP	'BBB+'	Stable	'BBB+'
Northern Border Partners, L.P.	'BBB+'	Stable	'BBB+'
Texas Gas Transmission LLC	'BBB+'	Stable	'BBB+'
At Segment Median Rating			
Boardwalk Pipelines, LLC	'BBB'	Stable	'BBB'
CenterPoint Energy Resources Corp.	'BBB'	Stable	'BBB'
Duke Energy Field Services, LLC	'BBB'	Stable	'BBB'
Enogex Inc.	'BBB'	Stable	'BBB'
Kinder Morgan, Inc.	'BBB'	Negative	'BBB'
Panhandle Eastern Pipe Line Co.	'BBB'	Stable	'BBB'
Texas Eastern Transmission, LP	'BBB'	Stable	'BBB'
Below Segment Median Rating			
Energy Transfer Partners, L.P.	'BBB–'	Stable	'BBB–'
Enterprise Products Operating, L.P.	'BBB–'	Stable	'BBB–'
Kaneb Pipe Line Operating Partnership, L.P.	'BBB–'	Stable	'BBB–'
Western Gas Resources, Inc.	'BBB–'	Stable	'BBB–'
Northwest Pipeline Corp.	'BB+'	Stable	'BB+'
Transcontinental Gas Pipe Line Corp.	'BB+'	Stable	'BB+'
Williams Companies, Inc.	'BB'	Stable	'BB'
SemCams Midstream Co.**	'B+'	Stable	'B'
SemCrude, LP**	'B+'	Stable	'B'
SemGroup, L.P.	'B+'	Stable	'B'

*Senior unsecured. **Indicative rating. IDR – Issuer default rating. Note: Median ratings based on senior unsecured debt. Note: Calculation of median ratings has changed from previous years. Source: Fitch Ratings.

Public Power Utilities

Most public power credits performed well in 2005, benefiting from solid growth in electricity demand and stable financial performance. Rising fuel costs and larger capital expenditures for new power generation were the biggest industry concerns, but despite these factors, municipal electric systems, rural electric cooperatives and federal power marketers demonstrated sufficiently good results to maintain their debt ratings, which are primarily in the 'A' to 'A+' categories.

Self-regulated public power utilities continue to benefit from their ability to pass through higher fuel costs on a timely basis. This is a distinct advantage compared with many investor-owned utilities. Also, public power is less reliant on natural gas as a primary fuel source compared with certain corporate and merchant utilities. However, because of higher energy costs, Fitch has observed some systems tapping into unrestricted cash reserves more quickly than first expected, becoming more challenged in their ability to maintain historically high debt-service coverage and operating margins. This trend may continue and could possibly place downward pressure on some public power ratings.

Overall, Fitch expects public power to fare well in 2006 and in the five-year horizon.. Utility managers and boards have so far demonstrated a willingness to pass along higher costs and plan for the energy needs of their native-load customers in an effective manner. Unexpected global events could change this strategy, but the public power industry looks to be well-positioned for the environment of 2006 and beyond.

Public Power Utilities

	Rating*	Rating Outlook
Above Segment Median Rating		
Tennessee Valley Authority	'AAA'	Stable
San Antonio City Public Service	'AA+'	Stable
Associated Electric Cooperative Inc.	'AA'	Stable
Chattanooga — Electric Power Board	'AA'	Stable
Chelan County Public Utility District No. 1	'AA'	Stable
Colorado Springs Utilities	'AA'	Stable
Grant County Public Utility District No. 2 (2 projects)	'AA'	Stable
JEA — Water and Sewer	'AA'	Stable
Lincoln — Electric System	'AA'	Stable
Memphis — Memphis Light, Gas and Water	'AA'	Stable
Nashville & Davidson County Metropolitan Government — Electric System	'AA'	Stable
New York Power Authority	'AA'	Stable
Orlando Utilities Commission	'AA'	Stable
Platte River Power Authority	'AA'	Stable
South Carolina Public Service Authority	'AA'	Stable
Springfield — City Utilities (2 projects)	'AA'	Stable
St. Cloud — Utility System	'AA'	Stable
JEA — Electric	'AA–'	Stable
Riverside — Public Utilities	'AA–'	Stable
Arkansas Electric Cooperative Corp.	'AA–'	Negative
Concord — Utilities System	'AA–'	Stable
Energy Northwest	'AA–'	Stable
Georgia Transmission Corp.	'AA–'	Stable
Imperial Irrigation District	'AA–'	Stable
Intermountain Power Agency	'AA–'	Stable
Los Angeles Department of Water & Power	'AA–'	Stable
New Braunfels Utilities	'AA–'	Stable
Pasadena — Water and Power Department	'AA–'	Stable
Pedernales Electric Cooperative, Inc.	'AA–'	Stable
Tallahassee — Energy System	'AA–'	Negative
Western Minnesota Municipal Power Agency	'AA–'	Stable

*Senior unsecured. Source: Fitch Ratings.

Public Power Utilities (cont.)

	Rating*	Rating Outlook
At Segment Median Rating		
Anaheim Public Financing Authority	'A+'	Stable
Austin — Combined Utility System	'A+'	Stable
Austin Energy	'A+'	Stable
Austin — Water and Wastewater System	'A+'	Stable
Ohio Water Development Authority — Buckeye Power, Inc.	'A+'	Stable
Connecticut Municipal Electric Energy Cooperative	'A+'	Stable
Dover	'A+'	Stable
Eugene Water & Electric Board	'A+'	Stable
Farmington — Utility System	'A+'	Stable
Florida Municipal Power Agency (4 projects)	'A+'	Stable
Glendale — Water and Power	'A+'	Stable
Indiana Municipal Power Agency	'A+'	Stable
Jacksonville Beach — Combined Utility System	'A+'	Stable
Kansas City — Board of Public Utilities	'A+'	Stable
Kerrville Public Utility Board	'A+'	Stable
Lakeland Energy System	'A+'	Negative
Long Beach — Gas Utility System	'A+'	Stable
Lower Colorado River Authority	'A+'	Stable
Modesto Irrigation District	'A+'	Stable
M-S-R Public Power Agency	'A+'	Stable
Municipal Electric Authority of Georgia (4 projects)	'A+'	Stable
Municipal Gas Authority of Georgia (2 projects)	'A+'	Stable
National Rural Utilities Cooperative Finance Corp.	'A+'	Stable
Nebraska Public Power District	'A+'	Stable
Ocala	'A+'	Stable
Rochester Public Utilities	'A+'	Stable
Roseville Electric System	'A+'	Stable
Snohomish County Public Utility District No.1	'A+'	Stable
Tacoma — Power	'A+'	Stable
Turlock Irrigation District	'A+'	Stable
Walnut Energy Center Authority	'A+'	Stable
Wisconsin Public Power, Inc.	'A+'	Stable

*Senior unsecured. Source: Fitch Ratings. Continued on next page.

Issuer Default Ratings (IDRs) and Recovery Ratings

In 2005, Fitch assigned new IDRs for its North American corporate issuers, including those in the North American global power segment. Fitch did not issue IDRs to public finance or public power issuers, however. The IDR initiative is part of a plan across all of Fitch to make its ratings more useful and informative to investors. In particular, the two objectives that inspired this change were to enable investors that are financial institutions subject to the Basel regulations to measure the capital required to support their investment assets and to provide more explicit information about expected recovery to high-yield investors.

The IDR reflects the ability of an issuer to meet all financial commitments on a timely basis, and it is now Fitch's benchmark measure probability of default. Securities in an issuer's capital structure are rated higher, lower or the same as the IDR based on their relative recovery prospects, as detailed in Fitch's reports, "Issuer Default Ratings and Recovery Ratings in the Power and Gas Sector," dated Nov. 7, 2005, and "Fitch Completes North American Global Power IDR Assignments," dated Dec. 5, 2005, available on Fitch's Web site at www.fitchratings.com.

In the case of issuers with IDRs of 'B+' and lower, individual securities are assigned recovery ratings based on the anticipated enterprise value in a hypothetical stress situation and then distributed to holders of securities based on their seniority. Issue ratings embody both the IDR and the recovery rating.

The methodology for implementing IDR ratings for issuers with ratings of 'BB–' and higher is based on the hierarchy of debt instruments in the capital structure, historical debt-recovery levels and the average regulated or nonregulated business risk profile as opposed to issuer-specific enterprise valuation. This method is used as default and is not imminent, and the capital structure will likely change over time. For this reason, recovery assessments are based more on long-term averages for recovery for that particular debt class (i.e., first-mortgage bonds of a regulated utility would be assigned the highest recovery rating of 'RR1' based on the presumption of recovery of at least 90% of principal).

The initiation of IDRs across the global power portfolio with ratings at or above 'BB–' resulted in only modest rating revisions. By contrast, there were more adjustments on a relative basis to the ratings instruments of speculative-grade issuers (i.e., those with IDRs of 'B+' and lower). With approximately 200 global power issuers with ratings of 'BB–' or higher, only 15 of such issuers, or less than 8%, had rating changes in one or more debt instruments following the completion of the recovery analysis and IDR assignment. At the instrument level, there were 19 rating revisions, 15 upward revisions and four downward revisions. The 19 rating revisions were concentrated in first-mortgage bonds and preferred stock, representing the highest ranking and lowest ranking instruments in the capital structure.

Bankruptcy and Restructuring

The key bankruptcy and restructuring events in 2005 for the U.S. power and gas sector center on three different stages in the bankruptcy process: Mirant Corporation's (Mirant) expected reorganization, Entergy New Orleans Inc.'s (ENOI) Chapter 11 bankruptcy filing in the wake of massive damage from Hurricane Katrina and Calpine Corp.'s (Calpine) weakened solvency.

Mirant

In anticipation of Mirant's emergence from bankruptcy in the near future, Fitch announced expected ratings for the reorganized Mirant and subsidiaries Mirant North America, LLC, Mirant Americas Generating, LLC and Mirant Mid-Atlantic, LLC. Fitch expects to assign a 'B+' IDR to Mirant and its subsidiaries, recognizing the improvement in the capital structure in the plan of reorganization, under which consolidated debt will be reduced to $5.4 billion, including leases, from $11.2 billion prepetition. Most of the prepetition debt will be repaid in full, but three issues aggregating $1.7 billion are to be reinstated after the payment of accrued interest. Recoveries by unsecured prepetition bondholders of 100% was higher than Fitch's initial expectations of 60%–80%, reflecting the strong value of Mirant's North American properties, in particular its coal-fired mid-Atlantic power fleet, as well as the substantial cash flows from international power assets. For more information, see the press release, "Fitch Assigns Expected Ratings to Mirant Corp. & Subsidiaries," dated Dec. 8, 2005.

ENOI

On Sept. 23, 2005, ENOI filed a voluntary petition for bankruptcy under the provisions of Chapter 11. The filing resulted from insolvency caused by the significant restoration costs and revenue loss associated with the destruction of ENOI's