CREDIT RATINGS

RATINGS ACTIVITY SLIGHTLY AHEAD OF LAST YEAR'S PACE

By Aaron Trent

Twenty-four ratings actions affected 11 parent companies or their subsidiaries in the second quarter. At 34 actions, ratings activity for the first half of 2009 was slightly ahead of last year's pace (at 27 actions), but well below that of the previous six years. (See Table 1.) At the parent company level, the industry's average long-term rating remained a solid BBB, essentially unchanged since 2004. The high level of ratings actions in 2002 and 2003, which pushed the parent-level average as low as BBB- in 2002, was spurred by a major expansion into unregulated businesses.

The percentage of ratings actions due to upgrades has fallen from approximately 61 percent in 2005-2007, to 48 percent in 2008, and to 32 percent for the first half of 2009. (See Figure 1.) The decline can be attributed in part to higher capital spending. On a trailing 12-month basis, industry capex has risen from $40.1 billion as of September 30, 2004, to $85.1 billion as of March 31, 2009. As a result, in 2007 the industry entered a period of negative pre-dividend free cash flow, which will likely continue for some time. Based on a June 2009 Edison Electric Institute (EEI) survey, EEI estimates shareholder-owned electric utility capex will reach $84.2 billion in 2009, $84.8 billion in 2010, and $86.6 billion in 2011. The average interest rate paid on new 10-year bonds issued by regulated utilities and holding companies has declined since the most acute phase of the financial crisis late in 2008 but remains high relative to risk-free rates. Coupons on bonds issued in the second quarter averaged 6.4 percent versus the first quarter's 6.7 percent and the fourth quarter's crisis peak of 8.2 percent, according to EEI's research. Higher average interest expense will affect operating cash flows for many companies going forward.

In this environment, relationships between companies and their regulators are especially important to utilities' financial health. Companies will continue to seek timely recovery of their investments in reliability, environmental controls, new generation, transmission, and distribution.

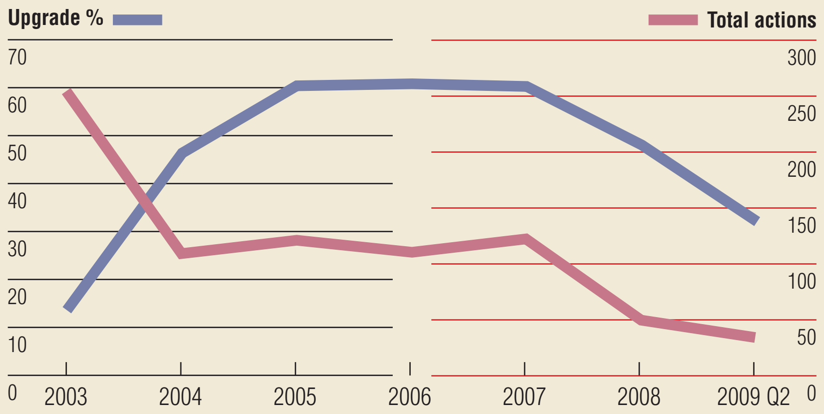
Aaron Trent (atrent@eei.org) is manager of financial analysis at Edison Electric Institute.

TABLE 1
TOTAL RATINGS ACTIONS
(U.S. shareholder-owned electric utilities)

	2002	2003	2004	2005	2006	2007	2008	2009*
Fitch	57	62	34	22	31	41	17	8
Moody's	118	79	42	46	39	32	6	13
Standard & Poor's	125	112	34	53	40	48	27	13
Total	300	253	110	121	110	121	50	34

* Through June 30, 2009
Note: Full year, except where noted.
Source: Fitch Ratings, Moody's, Standard & Poor's

FIGURE 1
DIRECTION OF RATINGS ACTIONS
(U.S. shareholder-owned electric utilities)



Note: Full year, except where noted.
Source: Fitch Ratings, Moody's, Standard & Poor's

Regulatory Challenges Spur ConEd Downgrades

During the second quarter, Moody's made two-notch downgrades to both the issuer and senior unsecured ratings of Consolidated Edison (to Baa1 from A2) and its subsidiaries Consolidated Edison Company of New York (to A3 from A1) and Orange and Rockland Utilities (to Baa1 from A2). The actions brought Moody's ratings on ConEd of New York into alignment with Standard & Poors' (S&P) issuer and senior unsecured rating of A-. S&P last downgraded the subsidiary in March 2008, by one notch. Moody's cited weakened financial metrics for the downgrade and believes that New York utility regulators will try to minimize the impact on rates of high capital expenditures and the supply cost increases likely in a carbon-constrained world.

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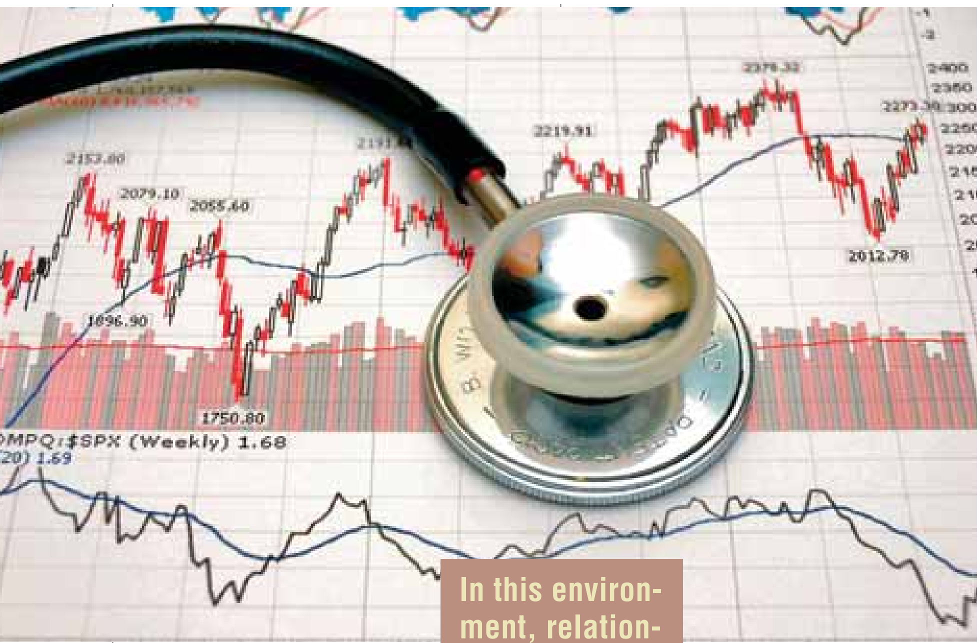
Nuclear Plans Contribute to Downgrades at SCANA

Both S&P and Fitch downgraded parent company SCANA and its subsidiaries South Carolina Electric & Gas Company (SCE&G) and Public Service Company of North Carolina. In all three cases, the agencies downgraded the companies' issuer rating by one notch to BBB+ from A-. Both S&P and Fitch cited increased business and financial risk from SCE&G's plans to build two nuclear units. Fitch also cited a decline in credit metrics over the last 18 months, while remarking that the credit impact of any nuclear plant development will be partly offset by credit-supportive legislation in South Carolina. The state's Base Load Review Act "allows utilities to recover capital costs, including a return on equity, during construction." Additionally, both S&P and Fitch expect equity issuance by SCANA to reduce the impact of capital spending on credit quality.

Iberdrola Guarantee Prompts Energy East Upgrade

Moody's and S&P took various actions on Spanish utility Iberdrola's U.S. subsidiaries, prompted in part by Iberdrola's announcement that it will guarantee Energy East's (EEC's) parent-level debt. Moody's upgraded its rating on $1.3 billion of EEC parent company senior notes to A3 from Baa2; S&P upgraded EEC's issuer rating to A- from BBB+. S&P noted that EEC's "stable" ratings outlook now reflects Iberdrola's strong business profile and financial policies.

Notwithstanding the credit benefit of Iberdrola's financial support, Moody's downgraded each of EEC's rated subsidiaries—New York State Electric & Gas, Rochester Gas & Electric, Central Maine Power, Connecticut Natural Gas, Southern Connecticut Gas, and Berkshire Gas—by one notch. The agency opined that EEC is somewhat over-reliant on bank credit and said it expects weakness in key metrics to continue at both EEC and its subsidiaries for several years due to the weak economy and the companies' need to finance capital spending. Moody's emphasized the importance of pending and future rate case outcomes to these companies' financial performance and ability to pursue the



full scope of current capital spending plans.

S&P stated that its ratings on EEC's subsidiaries are based mainly on each utility's stand-alone credit profile because none is a significant source of cash flow for Iberdrola. The agency upgraded Connecticut Natural Gas and Southern Connecticut Gas on continued low operating risk, relatively strong local economies, and supportive regulation. It downgraded Rochester Gas & Electric on higher regulatory risk relative to EEC's other subsidiaries and limited growth opportunities.

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Upgrades at TECO and Tampa Electric

Moody's and S&P upgraded TECO Energy subsidiary Tampa Electric to Baa1 and BBB, respectively, from Baa2 and BBB-, citing cost controls and rate increases that will help the company perform financially in spite of the weak economy in its service territory. At the parent level, S&P upgraded TECO Energy to BBB from BBB-, but Moody's only affirmed its ratings on TECO holding company debt, which widened the gap between holding company and utility debt from one to two notches to better reflect the structural subordination of the non-utility debt. Moody's noted that Tampa Electric expects its capital expenditures to fall, after peaking in 2009, "as projects are completed and others are deferred to levels more in-line with near-term demand."

Regulatory Clarity Spurs DP&L Upgrades

Moody's and S&P each upgraded DPL subsidiary Dayton Power and Light Company (DP&L) to A2 and A-, respectively, from A3 and BBB. At the parent level, S&P upgraded DPL's issuer rating to A- from BBB, while Moody's upgraded DPL's senior unsecured rating to Baa1 from Baa2. Both agencies cited the Public Utilities Commission of Ohio's approval of a settlement agreement regarding DP&L's proposed Electric Security Plan, which creates regulatory clarity through at least 2012. S&P said that the agreement allows DP&L to implement a fuel-recovery rider in 2010 while both agencies referred to DP&L's "strong" cash flow metrics. Moody's stated that DP&L has completed a large portion of currently mandated environmental capital expenditures and expects the company will be one of relatively few utilities achieving positive cash flow during the next several years. ◆

SAFETY

CREATING A CULTURE OF PREVENTION

By Charles E. Basham and Brennan J. Culver

All utility departments face budget challenges. Even those involved in public safety need to win and maintain internal support and funding for public outreach initiatives. The real secret ingredient for an enduring and effective safety program is to create a culture of prevention throughout your company.

A culture of prevention recognizes that public safety supports significant outcomes for the business: saving lives, preventing injuries, reducing costs, mitigating litigation, and enhancing the value of the utility's brand. When considered as part of a company's overall business strategy, a culture of prevention has the potential for increasing shareholder value.

Successful public safety outreach requires following a specific process, employing utility-specific best practices, and collecting and analyzing metrics. To put it all together, there are five key ingredients of a successful program: develop a strategic plan; document what you do; learn from experience and improve your results; share proof of your success with stakeholders; and seek expert guidance.

However, with the overall economy struggling, utility managers are under enormous pressure to reduce expenses as much as possible. And public safety costs, like all areas of a utility's business, are being carefully scrutinized. An economic case can be made to support (and even increase) funding for public safety outreach.

Charles E. Basham is manager of public safety at Southern California Edison in Westminster, CA, and Brennan J. Culver is principal at Culver Company in Larkspur, CA.