

Publication date: 20-Apr-2001  
Reprinted from RatingsDirect

Commentary

## U.S. Utility Rating Downgrades Outpace Upgrades in First Quarter; Negative Trend Likely To Continue

Analyst: Barbara A Eiseman, New York (1) 212-438-7666; Craig Hauret, New York (1) 212-438-7938

### California Crisis

Expectations for  
Increased  
Downward  
Pressure From  
the 'A-' Level

Financing  
Up: Leverage  
Likely To Rise  
Cash Flow To  
Decline

### Looking Ahead

Downgrades  
Dominate

Few Upgrades

CreditWatch  
Listings  
Outlook  
Revisions Heat  
Up

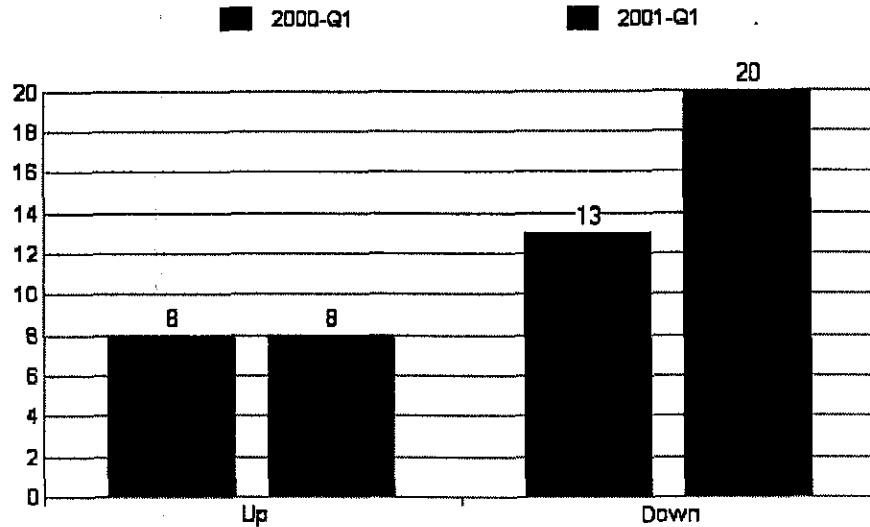
Downside rating actions continued to strongly overshadow upward rating activity in the U.S. utility industry (electric, gas, pipelines, and water) in this year's energetic first quarter. Although the negative trend mirrored that of the first three months of 2000, the actual number of rating changes has picked up a bit. There were 28 rating changes (20 downgrades, 8 upgrades) among holding companies and operating subsidiaries, several outlook revisions to negative, and a material increase in negative CreditWatch listings during the first quarter of 2001. In contrast, there were 21 rating changes (13 downgrades, 8 upgrades) for the same period a year earlier and only a handful of outlook revisions and CreditWatch placements, all of which were negative.

The increase in this quarter's rating activity can be traced to the California energy and liquidity crisis that led to numerous consecutive downgrades on PG&E Corp. and Edison International, and their affiliates. The declining credit picture continues to be mainly influenced by mergers and acquisitions, capital and corporate restructuring efforts, erosion of bondholder protection parameters, investments outside the traditional regulated utility business, and, with respect to California's two-largest utilities, defaults. These trends, in turn, reflect companies' strategies to deal with an increasingly competitive market while also seeking to increase shareholder value in this more uncertain environment.

Exhibit No. 100  
Date 6-01-01 Case No. ER-2001-299  
Reporter xf

Ex. 100

## Rating Actions

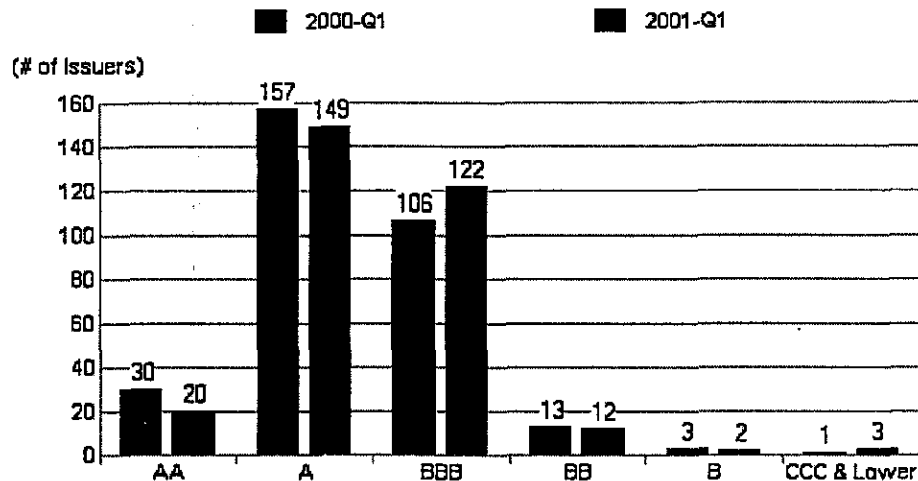


### California Crisis

Pacific Gas & Electric Co. (PG&E), parent PG&E Corp., and Southern California Edison Co. (SoCalEd) began to default on their financial obligations in mid-January, at which time the corporate credit ratings were dropped to 'D'. On April 6, PG&E filed for Chapter 11 bankruptcy protection, stating that its return to financial solvency would be better served in bankruptcy court. Indeed, since last summer, the company and its investors have experienced only frustration: First, with respect to stemming the drain of its financial resources by the malfunctioning wholesale power market before these resources finally ran dry, and then with its attempts to recover these resources.

With respect to SoCalEd, Standard & Poor's finally sees prospects for improved credit quality as a result of the utility's memorandum of understanding (MOU) with the California Department of Water Resources (CDWR). If several prerequisite conditions outlined in the MOU are met, proceeds of a securitization financing and the sale of SoCalEd's transmission assets to the state of California will inject badly needed funds into the utility. The parties' stated goal is to raise SoCalEd's credit quality to investment grade once again. At this time it is impossible to ascertain whether that goal can be achieved.

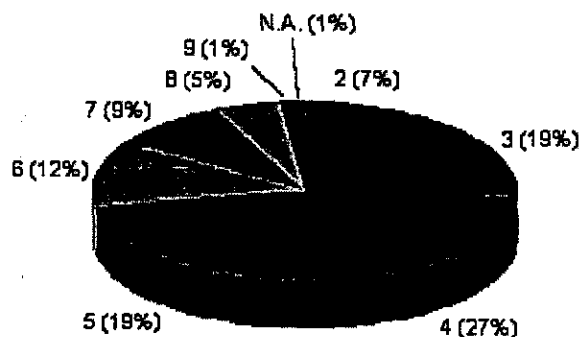
## First Quarter Rating Distributions, 2000-2001



### Expectations for Increased Downward Pressure From the 'A-' Level

In just a 12-month period the number of companies rated 'A' and above has declined while the number of firms rated 'BBB' and below has increased. In this regard, about 40% of the industry now carries a 'BBB' category rating, and 6% is rated below investment grade—compared with 34% and 5%, respectively, during the first quarter of 2000. In addition, 54% of the industry carry ratings of 'A' and above, versus 61% one year earlier. Notwithstanding this large number of rating downgrades and ongoing negative pressures on utility creditworthiness, the average rating for the industry remains at 'A-'. Still, the sector is highly rated, certainly compared with the U.S. industrials' average credit rating of 'BB+'. This is in line with the large percentage of utilities having average or above average business profiles.

### Business Profiles



Over the long term, Standard & Poor's expects that most companies providing electricity and gas will continue to maintain financial profiles that warrant, at a minimum,

investment-grade ratings. However, as the vertically integrated industry continues to disaggregate into its component parts of generation, transmission, and distribution, ratings will become more broadly dispersed. The recent trend toward corporate and capital restructuring is beginning to focus on the value and strategic advantages of IPOs and spin-offs. These newly formed entities will achieve ratings based on their financial performance and business risk, while the operations of the original company will be judged separately. Also, utilities that merge with other companies and invest outside the traditional regulated businesses will be rated on the basis of the qualitative and quantitative fundamentals of their consolidated entities. Prospective rating revisions will likely reflect the pace of deregulation among the states (and the impact of the California deregulation debacle), the degree to which unregulated operations increase business risk, as well as the degree of structural or regulatory insulation. Without posting stronger earnings and cash flow measures to compensate for riskier business profiles, ratings could deteriorate.

### **Financing Up...Leverage Likely To Rise, Cash Flow To Decline**

Financing activity has risen dramatically during the past 12 months. The amount of debt and preferred stock issued during the first quarter of this year exceeded the \$23 billion mark, compared with about \$17.5 billion issued during the first quarter of 2000. The increase in debt financing can be traced to depressed stock prices, a focus on shareholder value, somewhat lower interest rates, accelerating capital expenditures that are primarily related to improvements to existing transmission, distribution and generation facilities, and investments in nonutility ventures.

The higher level of financing and incremental debt burden will likely drive down key financial parameters, which have been eroding in recent years. Total debt as a percentage of capital has risen to substantial levels and at Dec. 31, 1999 (the latest year in which comparable data is available) stood at some 55%, versus 53% four years earlier. Much of the increase is attributable to debt raised at the parent or intermediate holding company level to fund unregulated operations. The increase in debt leverage has resulted in a steady decline in the funds from operations (FFO) to total debt and FFO interest coverage ratios. In this regard, FFO to total debt fell to 20.98% in 1999 from 24.47% in 1996, and FFO interest coverage slipped to 3.7x in 1999 from 4.12x in 1996. These ratios are characteristic of 'BBB'-rated companies. Of course, there are several other financial and qualitative factors that determine credit quality, but given the negative pressures on the industry, it will be increasingly difficult to sustain the 'A-' average rating.