Presentation at the Federal Energy Regulatory Commission's Technical Conference on Public Utility Holding Company Act of 2005 and Federal Power Act Section 203 Issues
December 7, 2006

Denise M. Furey
Senior Director
Fitch Ratings

Good afternoon. I am Denise Furey and am a Senior Director in the Global Power Group of Fitch Ratings. Fitch Ratings is a NRSRO (Nationally Recognized Statistical Rating Organization). Fitch rates fixed income securities of municipal and sovereign governments as well as corporations. The Global Power Group rates the fixed income securities of electric and natural gas utilities and competitive electric suppliers. Our ratings range from AAA for the most credit worthy entities to D which is for issuers that are in default.

Today I plan to discuss how Fitch views money pools and how cash management practices can affect a company's ratings. The degree of treasury centralization and strength of external constraints governing cash management practices are two of many factors that Fitch considers in determining appropriate rating differentials among affiliate issuers within power and gas groups. Fitch notes that power and gas groups utilize a range of cash management practices. At one extreme is that all funding and cash management is performed by the parent or a service company with commingling of funds. At the other extreme is discrete debt issuance and cash accounts are maintained by each entity within the group. Fitch has no preferences regarding cash management practices. We simply rate accordingly.

The benefit of decentralized cash management practices is that individual members of a group generally have access to funding even in the event of the financial distress of affiliated companies. Also, tight external restrictions, such as regulatory or contractual limits, and internal corporate policies governing shared money pools promote strong affiliate ring fencing and, therefore, enable greater distinction in affiliate issuer ratings.

Fitch however understands the benefits of a centralized funding and cash management. Centralization can be more economic and less burdensome to administer than discrete treasury functions for each affiliate. In highly a centralized treasury structure where the parent company issues debt and provides all of the external capital to its subsidiaries, the subsidiaries are financially dependent on the parent for capital, thus there is little to no distinctions in ratings among the various group entities. Unlike affiliate groups in non-regulated industries, regulated power and natural gas companies rarely have completely shared external sources of long and short term funding. However, the use of shared money pools is a common cash management technique among affiliate public utilities.

Fitch has noted that the structure of money pools vary greatly within the industry. Some pools include the regulated and competitive supply entities in one pool. Other company groups have separate pools for regulated and deregulated subsidiaries. Some pools have limits on the intercompany advances based upon either size or credit quality. Other pools permit their regulated affiliate to only borrow from the pool but allow the competitive suppliers to both borrow and lend. One constant across the industry that we have seen is that parent companies are allowed to lend into the respective pool but not to borrow.

There are three main areas in which unrestricted use of money pools could lead Fitch to determine that there is insufficient ring-fencing to allow for ratings differentials among affiliates.

The first relates to access to short term financing. If an entity has no independent source of short term financing and is solely dependent on its parent or affiliates for short-term financing, then its default probability will be linked to the parent or affiliates and thus there will be more close linkage between their ratings.

The second relates to short term investments in entities of low credit quality. The most prudent short term investments are F1 rated (highest quality) instruments. Shared money

pools among investment-grade affiliates with excess cash to invest and speculative grade affiliates with ongoing borrowing needs increase the credit risk of the investment-grade entity. If the speculative grade affiliate were to declare bankruptcy, the inter-company money pool loans to the bankrupt affiliate would be an unsecured claim, pari passu with all of the other unsecured claims in the bankruptcy.

The third concern is bankruptcy related. Consolidated cash management accounts and failure to document fund transfers among affiliated companies as intercompany loans that carry market rates of interest could be factors contributing to a U.S. bankruptcy court's decision to consolidate a solvent company in the bankruptcy proceedings of its affiliate. However, substantive consolidation generally results from a combination of facts and circumstances, not a single factor.

In summary, while it is common practice for the natural gas and electric utility groups to use money pools as part of the cash management program, most have avoided identical ratings among affiliates because of the existence of one or more of the following factors in the group's cash management program.

- Allowing the parent to lend but not borrow from the money pool.
- Separate pools for regulated and competitive subsidiary groups.
- Although the group on a day-to-day basis may use the money pool to fulfill short-term funding needs, committed bank credit facilities are in place that each non-defaulting subsidiary can continue to access in the event an affiliate or parent is in default.
- Credit metric criteria for money pool advances.
- Restricting the maximum permitted borrowings of each affiliate to a level commensurate with its internal cash flow generation capability.
- Prohibiting financially stronger affiliates from lending the proceeds of external credit facility drawings or debt funding to affiliates of weaker credit quality.
- Preventing affiliates from providing ongoing long-term funding to one another as a result of perpetual rollovers of short-term money pool loans.