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U.S. Electric Utilities

Summary

The outlook for the electric utility industry is stable. Credit quality in this sector began a broad recovery in 2004 after significant deterioration in 2002 and 2003. We expect to see stable credit conditions in 2005 for most issuers as the key trends from 2004 continue.

Credit quality has been supported by a focus on core regulated activities that have relatively low business volatility, and by a sharp reduction of investments in riskier non-regulated businesses. There has also been a modest reduction in the industry's financial leverage over the past year. While most utilities will continue to have negative free cash flow after capital spending and dividends, Moody's expects that a majority of companies will show improvement in this measure in 2005.

Credit conditions have bottomed out for the merchant power subsector. The stable outlook for this subsector reflects the relatively low level of the existing ratings, which already incorporate the higher risk that is inherent in this business. Excluding utility affiliates and project finance issuers, the merchant power companies have speculative grade ratings. Issuers that own gas fired merchant plants and that do not have adequate hedging under long term contracts have been stressed by very poor spark spreads for the past two years. Although it may take 3 to 5 more years before electricity demand increases enough to absorb the overcapacity in the wholesale power market, conditions are expected to begin improving gradually in 2005 because little new capacity will be added over the next several years.

Upgrades of U.S. power issuers outnumbered downgrades in 2004, for the first time in three years, with 1.4 times as many issuers being upgraded as downgraded. This contrasts sharply with 2003, when there were four downgrades for each upgrade. A number of issuers that were downgraded in 2002 and 2003 were subsequently upgraded in 2004. This reflected successful efforts to shrink the cash drain from poorly performing unregulated investments or merchant energy businesses, and to improve weak liquidity positions. Xcel Energy and CMS Energy are examples of such upgrades. Other issuers simultaneously improved their financial profile and decreased business risk by divesting underperforming unregulated assets and reducing debt.

A substantial proportion of the downgrades in 2004 reflected concerns about regulatory decisions that limit cash flow or reduce the amount of allowed recovery for regulated investments. Idaho Power and United Illuminating are examples of such downgrades. This trend underscores the increasing importance of regulatory decisions as a key driver of credit quality. While troubled unregulated businesses had been a critical credit factor for many issuers, issuers have taken actions to address these problems and these situations have already been factored into ratings. Utilities now face a greater need to file for rate increases than at any time in recent years. Moody's expects a larger number of base rate case filings in 2005 in order to address higher spending needs after a long period in which most utilities were able to control costs through increased efficiency and by refinancing debt at lower interest rates. With rising operating costs, high fuel costs, and increased capital spending for system reliability and environmental compliance, more utilities will be seeking large rate increases in coming years. An assessment of the prospects for timely and adequate rate relief will be an important credit consideration.



FACTORS LIKELY TO IMPROVE CREDIT QUALITY FOR ISSUERS IN 2005 INCLUDE:

- A continued focus on relatively stable core regulated utility activities. This trend is favorable for credit quality because issuers that are wholly engaged in lower risk regulated utility operations can have weaker financial metrics at a given rating level. In contrast, companies which engage in riskier activities need to demonstrate stronger financial metrics for a given rating category.
- The trend for divestitures of poorly performing unregulated investments is expected to continue.
- Continued reductions in capital spending for activities that are outside the core utility business.
- Use of proceeds from asset sales and equity issuance for balance sheet improvement. Companies are taking advantage of the current attractive financing environment in order to refinance debt maturities and to improve their liquidity and financial flexibility.
- M&A activity is expected to increase, with asset transactions being more likely than corporate combinations, due to regulatory impediments to mergers of utility companies.
- Some companies may benefit from favorable rate decisions that provide significant rate increases that will cover their rising costs.
- Coal fired and nuclear generation should continue to have significantly lower operating costs than natural gas fired generation. Expiration of contracts and hedges may create favorable exposures for lower cost generators and negative exposures for higher cost generators.

FACTORS LIKELY TO BE A CONCERN FOR ISSUERS IN 2005 INCLUDE:

- Greater pressure for equity rewards has already led to significant increases in dividends in 2004. Further increases are expected, along with stock repurchases by some companies. The broad trend of balance sheet improvement is ending.
- Failure to execute planned balance sheet improvements. The negative rating outlook for several issuers reflects uncertainty about planned improvements in operating or financial performance. In some cases improvement relies upon large rate increases that regulators may not grant on a timely basis.
- Rising cost pressures are expected to result in rate increase requests that are large enough to provoke significant resistance by regulators.
- Utilities that are operating under rate freezes are vulnerable to financial deterioration due to rising costs.
- Capital spending is expected to increase to improve the reliability of transmission and distribution operations and to meet tighter environmental standards. Consistent with the industry's normal practice, higher capital spending will be primarily debt financed.
- Fuel prices are expected to remain high and subject to significant volatility. Natural gas prices are likely to decline from current levels but remain well above the historic average for the next few years. An increase in natural gas prices could pressure the creditworthiness of some utilities that do not have mechanisms for timely fuel cost recovery, as well as gas fired merchant generators that lack contracts.

Rating List by Issuer Family
December 29, 2004

	Senior Secured	Senior Unsecured	Commercial Paper
AES Corporation, (The)	Ba3	B2	—
AES Eastern Energy, L.P.	Ba1	—	—
AES Ironwood, L.L.C.	B2	—	—
AES Puerto Rico, L.P.	Baa3	—	—
AES Red Oak, L.L.C.	B2	—	—
IPALCO Enterprises, Inc.	Ba1	—	—
Indianapolis Power & Light Company	Baa2	—	—
ALLETE, Inc.	Baa1	(P)Baa2	—
Allegheny Energy, Inc.	—	B2	—
Allegheny Energy Supply Company, LLC	B1	B3	—
Allegheny Generating Company	—	B3	—
Monongahela Power Company	Ba1	Ba2	—
Potomac Edison Company (The)	Ba1	Ba2	—
West Penn Power Company	—	Ba1	—
Alliant Energy Corporation	—	—	P-3
Interstate Power and Light Company	A3	Baa1	P-2
Iowa Electric Light and Power Company	(P)A3	—	—
Iowa Southern Utilities Company	(P)A3	—	—
Wisconsin Power and Light Company	A1	A2	P-1
Ameren Corporation	—	A3	P-2
AmerenCIPS	A1	(P)A2	P-1
AmerenEnergy Generating Company	—	A3	—
AmerenUE	A1	(P)A2	P-1
CILCORP Inc.	—	Baa2	—
AmerenCILCO	A2	—	—
Illinois Power Company	Baa3	—	—
American Electric Power Company, Inc.	—	Baa3	P-3
Appalachian Power Company	Baa1	Baa2	—
AEP Texas Central Company	Baa1	Baa2	—
AEP Texas North Company	A3	Baa1	—
Public Service Company of Oklahoma	A3	Baa1	—
Southwestern Electric Power Company	A3	Baa1	—
Columbus Southern Power Company	—	A3	—
Indiana Michigan Power Company	—	Baa2	—
Kentucky Power Company	—	Baa2	—
Ohio Power Company	—	A3	—
American Ref-fuel Company LLC	Baa2	—	—
American Transmission Company LLC	—	A1	P-1
Aquila, Inc.	—	B2	—
Arkansas Electric Cooperative Corporation	—	A2	—
Astoria Energy LLC	Ba3	—	—
Avista Corp.	Baa3	Ba1	—
Black Hills Corporation	—	Baa3	—
Black Hills Power, Inc.	Baa1	—	—
Brooklyn Navy Yard Cogeneration Partners L.P.	Ba1	—	—
Central Hudson Gas & Electric Corporation	—	A2	—
CMS Energy Corporation	Ba3	B1	—
Consumers Energy Company	Baa3	(P)Ba1	—
Caithness Coso Funding Corp.	Ba1	—	—
Calpine Corporation	—	Caa1	—
Riverside Energy Center, LLC	Ba3	—	—
Rocky Mountain Energy Center, LLC	Ba3	—	—
Cedar Brakes I, L.L.C.	Caa1	—	—
Cedar Brakes II, L.L.C.	Caa1	—	—

Rating List by Issuer Family (Continued)
December 29, 2004

	Senior Secured	Senior Unsecured	Commercial Paper
CenterPoint Energy, Inc.	Ba1	Ba2	—
CenterPoint Energy Houston Electric, LLC	Baa2	—	—
Choctaw Generation Limited Partnership	Baa3	—	—
Cinergy Corp.	—	Baa2	—
Cincinnati Gas & Electric Company (The)	(P)A3	Baa1	P-2
PSI Energy, Inc.	A3	Baa1	P-2
Union Light, Heat & Power Company (The)	—	Baa1	—
Cleco Corporation	—	Baa3	—
Cleco Evangeline LLC	B1	—	—
Cleco Power LLC	A3	Baa1	—
Cogentrix Energy, Inc.	—	Aa3	—
Cogentrix Delaware Holdings, Inc.	Ba2	—	—
Coleto Creek WLE, LP	Ba2	—	—
Consolidated Edison, Inc.	—	A2	P-1
Consolidated Edison Company of New York, Inc.	—	A1	P-1
Orange and Rockland Utilities, Inc.	—	A1	P-1
Rockland Electric Company	A1	—	—
Constellation Energy Group, Inc.	—	Baa1	P-2
Baltimore Gas and Electric Company	A1	A2	P-1
Covanta Energy Corporation	Caa1	—	—
DPL Inc.	—	Ba3	—
Dayton Power & Light Company	Baa3	—	—
DTE Energy Company	—	Baa2	P-2
Detroit Edison Company (The)	A3	(P)Baa1	P-2
Dominion Resources Inc.	—	Baa1	P-2
Kincaid Generation, L.L.C.	Baa3	—	—
Virginia Electric and Power Company	A2	A3	P-1
Duke Energy Corporation	A3	Baa1	P-2
Duke Capital, LLC	—	Baa3	P-3
Duquesne Light Holdings, Inc.	—	Baa3	—
Duquesne Light Company	Baa1	Baa2	P-2
East Coast Power L.L.C.	Baa3	—	—
Edison International	—	(P)Baa3	—
Edison Funding Company	—	Ba1	—
Mission Energy Holding Company	B3	—	—
Edison Mission Energy	—	B1	—
Midwest Generation, LLC	Ba3	—	—
Homer City Funding LLC	Ba2	—	—
Southern California Edison Company	A3	Baa1	P-2
El Paso Electric Company	Baa2	—	—
Elwood Energy LLC	Ba2	—	—
Empire District Electric Company (The)	Baa1	Baa2	P-2
Energy East Corporation	—	Baa2	P-2
Central Maine Power Company	—	A3	—
Southern Connecticut Gas Company	A3	—	—
New York State Electric and Gas Corporation	—	Baa2	P-2
Rochester Gas & Electric Corporation	Baa1	(P)Baa2	—
Entergy Corporation	—	—	—
Entergy Arkansas, Inc.	Baa1	(P)Baa2	—
Entergy Gulf States, Inc.	Baa3	—	—
Entergy Louisiana, Inc.	Baa1	Baa2	—
Entergy Mississippi, Inc.	Baa2	(P)Baa3	—
Entergy New Orleans, Inc.	Baa2	—	—
System Energy Resources, Inc.	Baa3	(P)Ba1	—

Rating List by Issuer Family (Continued)
December 29, 2004

	Senior Secured	Senior Unsecured	Commercial Paper
Exelon Corporation	—	Baa2	P-2
Exelon Generation Company, LLC	—	Baa1	P-2
PECO Energy Company	A2	—	P-1
Unicom Corporation	—	—	—
Commonwealth Edison Company	A3	Baa1	P-2
FPL Energy American Wind, LLC	Baa3	—	—
FPL Energy Wind Funding, LLC	Ba2	—	—
FPL Group, Inc.	—	—	—
FPL Group Capital Inc	—	A2	P-1
Florida Power & Light Company	Aa3	—	P-1
FirstEnergy Corp.	—	Baa3	—
Cleveland Electric Illuminating Company	Baa2	Baa3	—
Jersey Central Power & Light Company	Baa1	—	—
Metropolitan Edison Company	Baa1	Baa2	—
Pennsylvania Electric Company	Baa1	Baa2	—
Ohio Edison Company	Baa1	Baa2	—
Pennsylvania Power Co.	Baa1	—	—
Toledo Edison Company	Baa2	—	—
Georgia Transmission Corporation	—	—	P-2
Great Plains Energy Incorporated	—	Baa2	—
Kansas City Power & Light Company	A2	A3	P-2
Green Mountain Power Corporation	Baa1	—	—
Hawaiian Electric Industries, Inc.	—	Baa2	—
IDACORP, Inc.	—	Baa2	P-2
Idaho Power Company	A3	Baa1	P-2
ITC Holdings Corp.	—	Baa3	—
International Transmission Company	Baa1	—	—
Juniper Generation, L.L.C.	Baa3	—	—
LS Power Funding Corporation	Baa3	—	—
Madison Gas and Electric Company	Aa2	Aa3	P-1
MidAmerican Energy Holding Co.	—	Baa3	—
CE Generation LLC.	Ba1	—	—
Salton Sea Funding Corporation	Ba1	—	—
Cordova Funding Corporation	B3	—	—
MidAmerican Energy Company	—	A3	P-1
NRG Energy, Inc.	Ba3	—	—
NSG Holdings II LLC	B1	—	—
NSTAR	—	A2	P-1
Boston Edison Company	—	A1	P-1
Northeast Utilities	—	Baa1	—
Connecticut Light and Power Company	A2	—	—
Northeast Generation Company	Baa3	—	—
Public Service Company of New Hampshire	A3	—	—
Western Massachusetts Electric Company	—	A3	—
Northwestern Corporation	Ba1	—	—
OGE Energy Corp.	—	Baa1	P-2
Oklahoma Gas & Electric Company	—	A2	P-1
Oglethorpe Power Corporation	—	—	P-2
Old Dominion Electric Cooperative	A3	—	—
Otter Tail Corporation	—	A2	—
PG&E Corporation	—	—	—
Pacific Gas & Electric Company	Baa2	(P)Baa3	—
PJM Interconnection, L.L.C.	—	Aa3	—

Rating List by Issuer Family (Continued)
December 29, 2004

	Senior Secured	Senior Unsecured	Commercial Paper
PPL Corporation	—	—	—
PPL Capital Funding, Inc.	—	Baa3	—
PPL Electric Utilities Corporation	Baa1	Baa2	P-2
PPL Energy Supply, LLC	—	Baa2	P-2
PPL Montana, LLC	Baa3	—	—
Pepco Holdings, Inc.	—	Baa2	P-2
Conectiv	—	Baa2	—
Atlantic City Electric Company	A3	Baa1	P-2
Delmarva Power & Light Company	A3	Baa1	P-2
Potomac Electric Power Company	A3	Baa1	P-2
Potomac Capital Investment Corporation	—	Baa2	—
Pinnacle West Capital Corporation	—	Baa2	P-2
Arizona Public Service Company	—	Baa1	P-2
Power Contract Financing, L. L. C.	Baa2	—	—
Power Receivable Finance, LLC	Baa2	—	—
Primary Energy Holdings LLC	B2	—	—
Progress Energy, Inc.	—	Baa2	P-2
Progress Capital Holdings, Inc.	—	A3	—
Progress Energy Florida, Inc.	A1	A2	P-1
Progress Energy Carolinas, Inc.	A3	Baa1	P-2
Public Service Company of New Mexico	—	Baa2	P-2
Public Service Enterprise Group Incorporated	—	Baa2	P-2
PSEG Energy Holdings L.L.C.	—	Ba3	—
PSEG Power L.L.C.	—	Baa1	—
Public Service Electric and Gas Company	A3	Baa1	P-2
Puget Sound Energy, Inc.	Baa2	Baa3	P-2
Reliant Energy Inc.	B1	(P)B2	—
Orion Power Holdings, Inc.	—	B2	—
Reliant Energy Mid-Atlantic Power Hldgs., LLC	B1	—	—
SCANA Corporation	—	A3	—
South Carolina Electric & Gas Company	A1	—	P-1
Sempra Energy	—	Baa1	—
San Diego Gas & Electric Company	A1	(P)A2	P-1
Sierra Pacific Resources	—	B2	—
Nevada Power Company	Ba2	—	—
Sierra Pacific Power Company	Ba2	—	—
Southern Company (The)	—	A3	P-1
Alabama Power Company	A1	A2	P-1
Georgia Power Company	A1	A2	—
Gulf Power Company	A1	A2	—
Mississippi Power Company	Aa3	A1	—
Savannah Electric and Power Company	A1	A2	—
Southern Company Funding Corporation	—	—	P-1
Southern Power Company	—	Baa1	P-2
Square Butte Electric Cooperative	A3	—	—
TECO Energy, Inc.	—	Ba2	—
Tampa Electric Company	(P)Baa1	Baa2	—
TNP Enterprises, Inc.	—	B1	—
Texas-New Mexico Power Company	—	Ba2	—
TXU Corp.	—	Ba1	—
TXU US Holdings Company	—	Baa3	—
TXU Electric Delivery Company	Baa1	Baa2	P-2
TXU Energy Company LLC	—	Baa2	P-2
Tenaska Georgia Partners, L.P.	Baa3	—	—
Tenaska Oklahoma I, L.P.	Ba2	—	—
Kiowa Power Partners, L.L.C.	Baa3	—	—

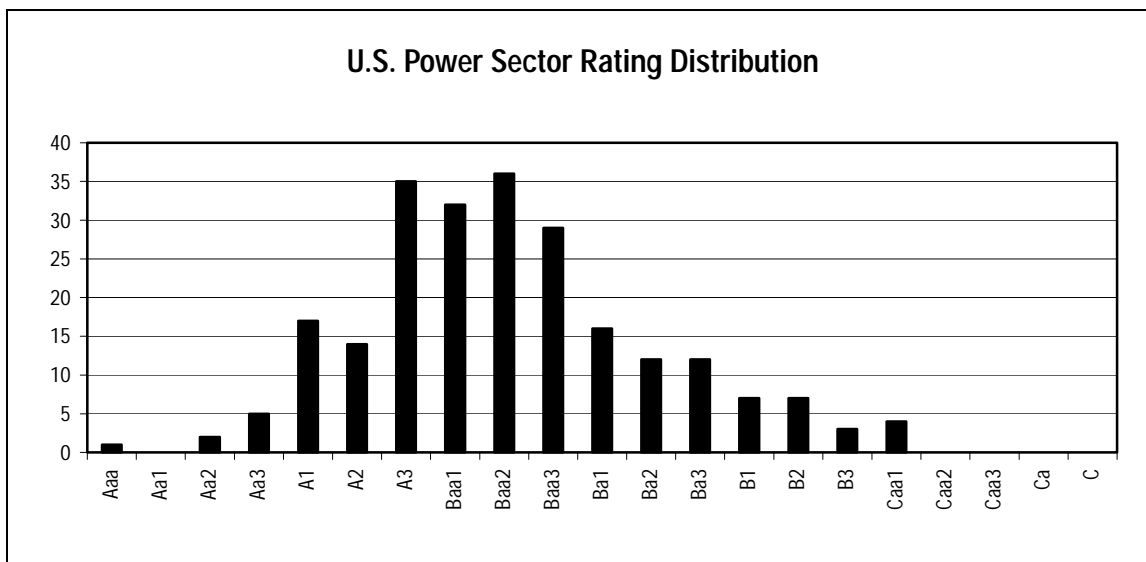
Rating List by Issuer Family (Continued)
December 29, 2004

	Senior Secured	Senior Unsecured	Commercial Paper
Tenaska Virginia Partners, L.P.	Baa3	—	—
Tenaska Washington Partners, L.P.	Baa2	—	—
Tennessee Valley Authority	—	Aaa	—
Teton Power Funding LLC	Ba3	—	—
Texas Genco LLC	Ba2	B1	—
Trans-Elect, Inc.	—	—	—
Trans-Elect NTD Holdings Path 15, LLC	Ba3	—	—
Trans-Elect NTD Path 15, LLC	Ba1	—	—
Tri-State G&T Association Inc.	Baa2	—	—
Tucson Electric Power Company	Ba2	—	—
UIL Holdings Corporation	—	—	—
United Illuminating Company	—	Baa2	—
Utility Contract Funding, L.L.C.	Baa1	—	—
WPS Resources Corporation	—	A1	P-1
Wisconsin Public Service Corporation	Aa2	Aa3	P-1
Westar Energy, Inc.	Ba1	Ba2	—
Kansas Gas & Electric Co.	Ba1	—	—
Wisconsin Energy Corporation	—	A3	—
Wisconsin Electric Power Company	Aa3	A1	P-1
Xcel Energy Inc.	—	Baa1	—
Northern States Power Company (Minnesota)	A2	A3	P-2
Northern States Power Company (Wisconsin)	A2	A3	—
Public Service Company of Colorado	A3	Baa1	P-2
Southwestern Public Service Company	—	Baa1	P-2

Industry Fundamentals

OVERVIEW

The power sector in the U.S. includes regulated utilities that have little unregulated activity, unregulated power generators and energy marketers. A majority of issuer families can be characterized as diversified entities that engage in some activities outside the power sector but which are predominantly involved in the production, transmission, marketing, and/or distribution of electricity.



The average rating for U.S. regulated electric utilities is Baa1. The ratings of investor owned operating utilities range from Ba2 to Aa2. The ratings of utility holding companies range from B2 to A1. One of the fundamental factors underlying the average credit quality of utilities is the tendency for regulators to balance their desire for low costs to utility customers against the need for utilities to have sufficient financial strength to finance capital spending that supports the long term provision of reliable service.

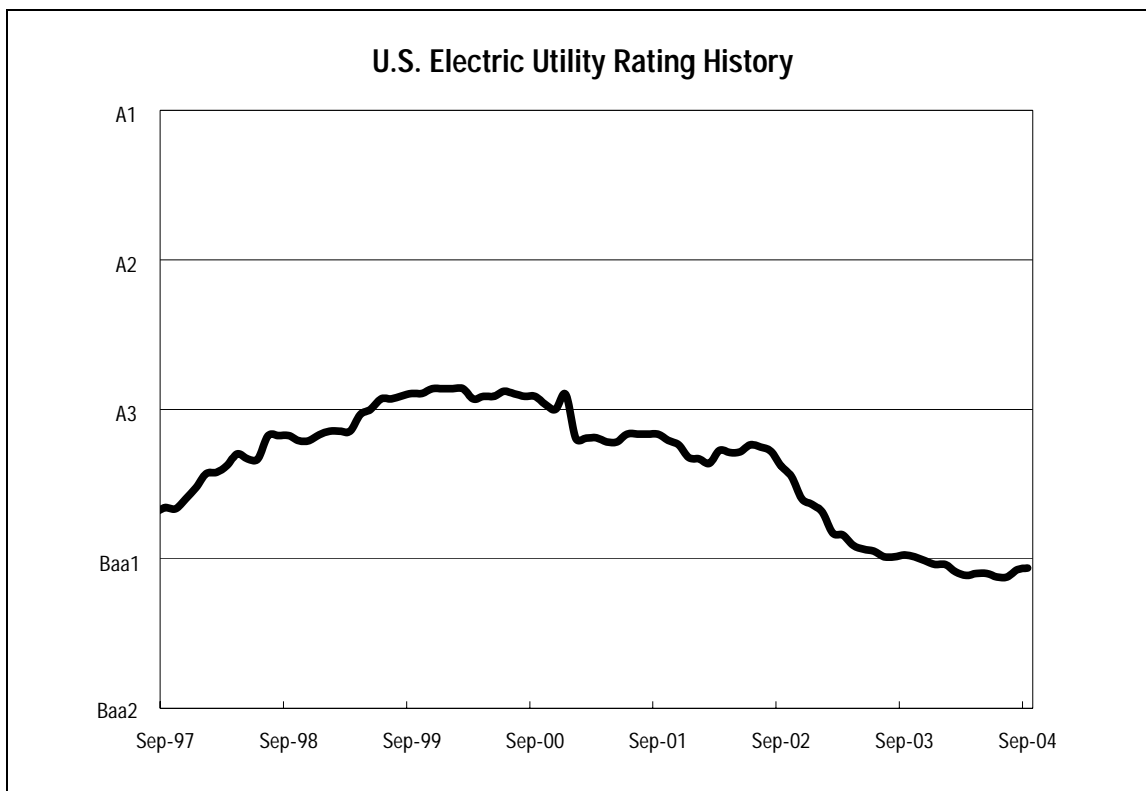
While only a handful of utilities have non-investment grade ratings, the number of such ratings has increased in recent years. Some utilities with speculative grade ratings have weak financial results due to higher risk unregulated activities that have not performed well. Other ratings reflect a lack of regulatory support for timely recovery of costs that relate to the regulated utility business, such as power purchase costs.

Some utility affiliates that could be categorized as merchant generators and a large number of project finance power generating entities that are supported by contractual arrangements have investment grade ratings. However, the stand-alone merchant generation companies all currently have speculative grade ratings. These issuers are significantly exposed to fluctuations in the price of power and fuel, and lack sufficient coverage from long term contractual arrangements with credit worthy counterparties to adequately mitigate price risks in a market with excess capacity.

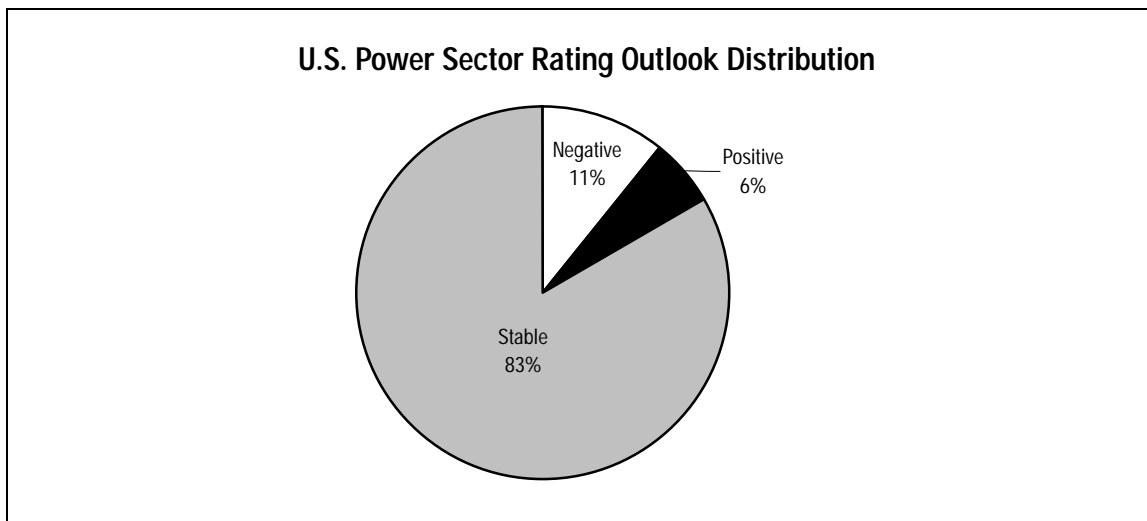
OUTLOOK IS STABLE, REFLECTING THE REBALANCING OF INDUSTRY RISKS

The electric utility industry has historically exhibited fairly stable credit quality in comparison to some other industries that are cyclical or which are sensitive to fluctuations in commodity prices. However, the movement towards deregulation of the power industry in the 1990s, coupled with management strategies to pursue higher risk investments that often were unrelated to the power business, led to a significant increase in balance sheet leverage and business risk. Many companies also participated in a debt financed construction boom for unregulated generating plants. Then margins fell sharply for unregulated wholesale power activities, the energy trading model collapsed, and diversified investments largely performed very poorly. As a result, the industry experienced a substantial decline in average credit quality.

While the problems were centered on unregulated investments, the credit quality of regulated affiliates was also affected to some degree. Even in cases in which substantial regulatory ring fencing type protection existed, there was an increased reliance upon the regulated utility subsidiaries to provide dividends to support the holding company's activities. Most companies are now espousing a "back to basics" strategy to focus on the core regulated utility business. Some of the remaining unregulated activities are those in which utilities have been more successful or which are more closely related to their core business. These trends suggest that there should be greater credit stability over the next few years.



The overwhelming majority of issuers (83%) in this sector have a stable rating outlook. About 11% of issuers have a negative outlook and 6% have a positive outlook. This ratio incorporates regulatory uncertainty for some issuers with upcoming rate cases that have credit metrics which are weak for their risk profile and rating category. The number of issuers under review for possible upgrade exceeded the number of issuers under review for possible downgrade all through the fourth quarter of 2004. This provides a more balanced picture of credit quality when contrasted with the higher number of issuers that have a negative outlook than a positive outlook. Currently there are 13 issuers under review for possible upgrade and only three issuers under review for possible downgrade.



REGULATORY RISKS WILL BE MORE IMPORTANT WITH INCREASED RATE FILINGS

Moody's believes that rate cases will be a more significant ratings driver in the next few years. Many states are approaching the end of transition periods that included multi-year freezes for utility rates. The large number of rate cases expected over the next several years will have a significant impact on the industry's overall financial strength and stability. According to the Edison Electric Institute, the industry faces as much as \$40 billion of rate reviews during a period of significant regulatory uncertainty. The underlying causes of the surge in the number of rate cases include higher operating costs, environmental expenditures, spending on infrastructure and reliability initiatives, higher fuel costs, and the need to diversify fuel and power supply sources.

Regulators have a powerful influence on credit quality in other areas, in addition to their review of rate requests. There will be a number of upcoming regulatory decisions related to the proposed inclusion of acquired generation assets in utility rate base and the timing and degree of recovery of costs for fuel and purchased power.

COST PRESSURES ARE RISING

Many utilities have been able to avoid filing a base rate case for several years, by holding down costs and increasing operating efficiencies. A long period of declining interest rates provided a multi-year opportunity to lower interest costs by refinancing maturing and callable debt. This allowed companies to lower their cost of capital, particularly utilities that were under a rate freeze related to market transition planning. With rising interest rates and higher costs for fuel, health benefits, pensions, and other operating costs, this period of reduced cost pressure has ended, and more utilities need to file for rate increases. Higher fuel costs have also translated into higher costs for purchased power.

There are significant differences in vulnerability to rising costs depending upon the degree to which an issuer is regulated and the nature of its regulatory regime. Unregulated generators are subject to market competition for unhedged power sales. This has resulted in higher margins and stronger cash flow generation for coal and nuclear based merchant generation, and a squeeze on margins for natural gas fired merchant generation. Moody's expects this tilt in the playing field to continue for at least several more years. The main cost threat for coal fired generators is a tightening of environmental standards. We expect further tightening of standards, with significantly higher capital spending over time, but also believe that new requirements will be implemented at a moderate pace because coal fired generation represents more than half of U.S. electricity production.

There are substantial differences in the certainty and timeliness of the pass through of costs for regulated utilities. Some state commissions provide for an automatic pass through of fuel and purchased power costs, some require a filing for recovery, and some have implemented rate freezes as part of a partial movement to deregulated markets. The

utilities that are under rate freezes are most vulnerable to rising fuel prices. Conversely, these utilities could also benefit the most if fuel costs were to drop substantially.

Lower cost utilities may be somewhat less likely to face severe resistance from ratepayers, regulators and various intervenors, but such resistance is often based on the relative size of the increase even if the resulting electricity price is regionally competitive.

WHOLESALE POWER SECTOR FACES A SLOW MULTI-YEAR RECOVERY

Most regions of the U.S. have substantial excess generating capacity and will not reestablish a healthy balance between supply and demand for a few years. The most important long term determinant of demand is economic growth. Assuming a 3% per annum growth rate for the U.S. economy, some of the areas with the greatest excess capacity, such as the Southeast, may not come into balance until after the end of the decade.

Fuel prices are another critical factor affecting the profitability of wholesale generation, particularly for natural gas fired plants. It is not possible to predict prices with any degree of certainty, but supply conditions strongly suggest that gas prices will remain well above the historic average for years to come. Unless there is a substantial increase in environmental costs for coal and nuclear plants, the fuel costs for natural gas merchant plants will continue to place these plants high on the dispatch curve where they are most vulnerable to weak market demand. When demand eventually returns to a reasonable balance, there could be considerable upside leverage for some wholesale power producers. Some of the weaker companies will have consistently negative free cash flow and will be reliant upon investors' willingness to provide new financing until the recovery develops.

Related Research

Industry Outlooks:

[U.S. Natural Gas Transmission & Distribution Sector, December 2004 \(90627\)](#)

[European Utilities, November 2003 \(80100\)](#)

Special Comments:

[Comparative ROE Attributes of U.S. Local Gas Distribution Companies, July 2004 \(87301\)](#)

[Uncertainties Remain with Respect to the Restructuring of the Texas Electric Utility Industry, March 2004 \(81796\)](#)

[Nuclear Power Trends in the United States, February 2004 \(81342\)](#)

To access any of these reports, click on the entry above. Note that these references are current as of the date of publication of this report and that more recent reports may be available. All research may not be available to all clients.

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