*Electric Utility Week, May 20, 2002*



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**SECTION:** Pg. 3

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**HEADLINE:** S&P SEES EIGHT POWER FIRMS AT RISK OF LIQUIDITY CRISIS IF DOWNGRADED

**BODY:**
Standard and Poor's said it has identified eight U.S. power and merchant energy companies that could face a liquidity crisis if their credit ratings were to deteriorate.

Following a review of U.S. and European companies across industries, the credit-rating agency found that Aquila, Black Hills, Dominion Resources, Dynegy, Mirant, PG&E National Energy Group, Reliant Resources and Williams each faces a "credit cliff," meaning that a credit downgrade could severely drain liquidity.

S&P officials in a conference call last week said they sought to review 1,000 U.S. and European investment-grade industrial and utilities companies through a survey that asked questions about exposure to so-called "contingent calls on liquidity," or demands on a company's available cash from such things as ratings triggers on debt and triggers on bank-lending facilities. The rating agency said it had reviewed responses from roughly 90% of those surveyed.

The officials said they found about 500 of those queried had "some form of contingent call on liquidity." The eight power and merchant energy companies are among 24 companies of all kinds that S&P identified -- 15 in the U.S. and nine in Europe -- that met the "credit cliff" profile. In determining such a profile, S&P, a McGraw-Hill Companies unit, said it looked at provisions in financing or operating agreements, particularly ratings triggers that could turn an otherwise modest decline in credit quality into a liquidity crisis.

The managing director of S&P's energy group noted that the merchant energy sector was "particularly confidence sensitive." In addition to triggers and other contingencies, collateral calls on trading operations were an added risk factor for merchant energy companies, he said. The S&P official also noted that the merchant energy sector's hard assets lend themselves "particularly well" to being placed into share trusts and in off-balance-sheet financing vehicles such as partnerships. These vehicles often have additional contingent calls on liquidity embedded in them, he said.

S&P said earlier this year it would undertake the review to address investor concerns in the wake of the defaults at Enron Corp. and California utilities Pacific Gas and Electric and Southern California Edison.

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Officials said the listing did not imply the companies would be placed on credit watch or be downgraded. The agency said it was releasing its findings to aid investors, who they said may not have sufficient information about the companies to judge the degree to which they face contingent calls on liquidity. The agency said it could not release all of the data from the survey because it was confidential.

S&P stressed in written materials "that even companies designated as having a credit-cliff profile might not face an imminent threat of either a credit event or a liquidity problem. The credit cliff possibility indicated here means only that a credit deterioration would be compounded by the provisions of the company's financial arrangements."

Following is a summary of the triggers at the eight companies and S&P ratings status:

AQUILA: (senior debt BBB): was put on CreditWatch -- Negative April 30 after it agreed to acquire Cogentrix. If it does not maintain investment-grade ratings required debt repayment s would be $ 174-million, the cost of issuing debt and equity would rise [and] counterparties could require more margin deposits, Aquila said in the first quarter Form 10-Q. Aquila Merchant, when a stand-alone company last year, issued project financing guaranties requiring it to meet covenants, including a fixed charge coverage ratio set on a rolling 12-month basis, which it did not for the period ending March 31.

Aquila got waivers for non-compliance. The covenants were crafted asssuming Merchant would be a stand-alone company but with the re-combination of Merchant into Aquila, it believes the covenants as drafted are no longer appropriate and is negotiating to amend them.

BLACK HILLS: BBB corporate rating was assigned Dec. 4, 2001. Black Hills Power senior secured was cut from A+ to BBB+ Feb. 15, 2002. The outlook is stable.

Bank facilities nclude covenants requiring a rating of at least BBB- from S&P or Baa3 from Moody's Investor Service, and if cut below that, it would be an event of default, Black Hills noted in the 2001 10-K. The lender could terminate the remaining commitment and demand immediate payment of outstanding principal and interest. At Feb. 28 there was $ 384-million outstanding under the facilities up from $ 360-million at Dec. 31.

DOMINION: senior unsecured rated BBB+, last affirmed, with a stable outlook, on Aug. 31, 2000.

Dominion Delivery's Dominion Fiber Ventures LLC unit owns Dominion Telecom. DFV senior notes are secured by DTI stock and partly by mandatorily convertible preferred stock, issued by Dominion and held by Piedmont Share Trust, of which Dominion is beneficial owner. If Dominion senior unsecured was cut to BBB- by S&P or Baa3 by Moody's (now Baa1), and the closing price of Dominion stock is below $ 45.97 for 10 straight trading days, the preferred is subject to remarketing, with proceeds used to retire the notes.

On May 16 Dominion declared chances "extremely remote" that these provisions would trigger be triggered. But that came after the stock slumped $ 3.13 (4.8%) to $ 61.64, down 8% in a year.

DYNEGY: on April 24 S&P cut senior unsecured from BBB to BBB-, and took it off CreditWatch -- Negative, but it was put back there May 8. The stock kept plummeting last week (story this issue).

MIRANT: S&P last affirmed senior unsecured at BBB- Dec. 20, 2001. The outlook remains stable.

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In March 2002 it agreed to **sell** its 50% share of the Perryville **plant** to partner Cleco. A month before, the tolling agreement with **Mirant** Americas Energy Marketing was amended so that if Mirant itself is cut below BB by S&P or Ba2 by Moody's, MAEM must post credit support of at least 125% of Perryville senior debt, plus debt service reserves.

If it does not maintain current investment ratings, it could have to provide alternative collateral to counterparties in order to continue its current relationship with them.

PG&E NEG: the BBB senior unsecured was last affirmed May 10 with a stable outlook.

"If NEG or its subsidiaries are downgraded by one or more agencies, NEG may be required to provide alternative collateral to replace guarantees that no longer meet creditworthiness standards of agreements." Exposure if NEG or units were cut to speculative by one or more agencies was about 5% of guarantees, or about $ 144-million at March 31, it added.

RELIANT RESOURCES: On May13 S&P put it on CreditWatch -- Negative. S&P cut the senior unsecured from BBB+ to BBB on March 21and moved the outlook to stable.

Resources has delayed filing its 10-Q to this week. In the 10-K it declared none of its $ 5-billion of credit facilities as of Dec. 31 " have any defaults or prepayments triggered by changes in credit ratings, or in any way linked to the price of our common stock or any other traded instrument."

WILLIAMS: ratings (senior unsecured BBB) were put on CreditWatch -- Negative Feb. 1.

Williams has cut "trigger' exposure of potential accelerated debt payment and redemption of preferred interests to $ 182-million," at March 31, down from $ 816-million at Dec. 31, it said in the 10-Q. In one deal it agreed to redeem a $ 560-million preferred interest over the next year.

If cut to speculative, Williams would have to fund margining requirements with cash, letters of credit or other negotiable instruments, up to $ 500-million as of March 31 without considering offsetting positions and margin deposits, it added, and the ability to participate in energy marketing and trading could be significantly limited.
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**Lenard, Rhonda**

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**From:** Talbot, Paul
**Sent:** Thursday, August 01, 2002 9:15 AM
**To:** Legal; Bridges, Pat; Hegwood, Joe
**Subject:** FW: Houston Chronicle Article

-----Original Message-----
**From:** Beck, Terry
**Sent:** Thursday, August 01, 2002 9:12 AM
**To:** Officers (FCP)
**Subject:** FW: Houston Chronicle Article

-----Original Message-----
**From:** Pannell, Lucy
**Sent:** Thursday, August 01, 2002 8:38 AM
**To:** FCP Sales
**Cc:** FCP Marketing
**Subject:** Houston Chronicle Article

# Reliant's credit rating tumbles

## Junk-bond status, Moody's says

**By LAURA GOLDBERG**


Moody's Investors Service, citing concerns about Reliant Resources' cash flow, cut its credit rating by three notches Wednesday to junk-bond status.

The company quickly went on the offensive, holding a conference call with analysts and investors to stress it has sufficient liquidity, which is cash or easy access to it, to cover its obligations.

Reliant Resources is the latest among companies involved in energy trading and marketing to have its credit rating dropped to noninvestment grade status.

The company, which is 83 percent owned by parent Reliant Energy and 17 percent held by public investors, has power plants and a retail electricity business that is Houston's main power provider.

It is slated to be split out as a stand-alone company later this summer. What's left of the parent company, mostly regulated operations, will be renamed CenterPoint Energy.

Reliant Energy said Wednesday it received the last regulatory approval needed, a letter from the Internal Revenue Service, for the separation to move ahead.

Generally speaking, a junk-bond rating increases a company's cost of doing business. It can hit a trading and marketing company hard as good credit is important because deals don't often settle right away. Those with lower ratings are often forced to back up their deals by posting collateral.

Moody's said it downgraded Reliant Resources because "cash flow from operations is unpredictable relative to its debt load, and its financial flexibility is limited."

Reliant Resources has bank loans totaling $1.3 billion due in October and December, while a $2.9 billion loan related to its acquisition of Orion Power Holdings expires in February.

The company is working to hammer out a package that would extend the maturities of its debt.

Moody's said the near-term outlook for Reliant Resources' wholesale energy business is poor because of depressed power prices and negative conditions throughout the energy trading industry. It did note, however, its retail power business "lends a measure of diversity" to earnings.

Reliant Resources shares traded down $1.08 to close at $4.62. Reliant Energy shares closed down 48 cents at $10.06.

Moody's took Reliant Resources ratings from Baa3 to Ba3.

Michael Worms, an energy analyst in New York with investment banking firm Gerard Klauer Mattison, said he believes it likely Reliant Resources will ultimately get its financing done. But the Moody's downgrade "certainly isn't going to help any," he said.

Standard & Poor's Ratings Services also downgraded Reliant Resources, although only one notch. It still has the company at an investment-grade status.

Its action, S&P said, reflected Moody's downgrade and the increased collateral requirements triggered as a result. S&P took the company's corporate credit ratings from BBB to BBB-.

Reliant Resources told analysts it expected to have to post an additional $650 million in various forms of collateral if both Moody's and S&P had cut to junk. Because only one did, the amount should be about $100 million to $200 million less.

The company said it has about $1.2 billion in cash and available credit lines to meet its needs.

Rating downgrades don't trigger any defaults under the debt agreements of Resources or its parent.

S&P agreed Resources has enough liquidity to cover the collateral increases, but remains concerned about ongoing federal investigations regarding certain of its previous trading practices.

All told, S&P said it believes Reliant Resources should succeed in its bank negotiations, adding that the banks should "gain comfort" from the company's diversified set of power plants and its retail electricity business.

Steve Letbetter, Reliant Resources chairman and chief executive, told analysts and investors he was disappointed by Moody's action but not surprised given industry conditions and pressures facing rating agencies.

The company, he said, doesn't deserve the new Moody's rating. Moody's didn't appear to recognize that Reliant Resources is different from others in its peer group for several reasons, including its retail electricity business, he said.

Letbetter took several questions about plans for the spinoff of Reliant Resources, which he said is moving ahead. Shareholders of Reliant Energy are eager for the spinoff to take place.

Moody's also downgraded the credit rating of Reliant Energy, focusing on the regulated businesses that will comprise CenterPoint. The downgrade puts it two notches above junk-bond status.

It's concerned that a delay in the spinoff would hamper Reliant Energy's ability to refinance $4.7 billion of bank lines expiring in October.

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As part of the process leading up to the spinoff, Reliant Energy and Reliant Resources hired consultant Houlihan Smith & Co. to perform so-called solvency opinions on both companies. The opinions, to be used by the Reliant Energy board as it considers the final steps for the separation, will state whether each company can stand as separate, financially viable enterprises.

At least one analyst pressed Letbetter to release those opinions before the board meeting, expected to be in late August or early September. He declined, saying the opinions aren't technically finished until they go to the board.

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## Corporate

### AES TO FREEZE NEW INVESTMENT IN SHORT TERM, SELL MORE ASSETS

Newly appointed AES President and CEO Paul Hanrahan Wednesday unveiled a stepped-up plan to restore the company's financial credibility that includes freezing new investment in the short term and increasing AES asset sales to raise cash.

Hanrahan, who replaced Dennis Bakke as head of AES Tuesday, told an analyst briefing that his plan aims to bring the company up to investment grade within two to three years and restore its position as "a premier global power company."

Hanrahan said his first priority is to reduce debt enough to enable AES bonds to trade at face value and that AES will make no new investments beyond current commitments until that occurs.

He also said AES has raised its debt-reduction target for 2003 from the current $1-billion to $2-billion. The extra funds will come from a combination of new asset sales and sales of equity. He did not identify specific assets that will be divested, but said they will not be restricted to poorly performing units. Quickly rebuilding AES's financial strength is

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## Washington

### AFTER WEEKS OF DELAY, ENERGY BILL CONFERENCE SET FOR JUNE 27;

The House-Senate conference on energy legislation will convene June 27, the House and Senate energy committee chairmen announced Wednesday. The conference will be chaired by House Energy Committee Chairman Billy Tauzin (R-La.).

Delays by the House leadership in naming conferees, and a disagreement over whether the conference would be chaired by Tauzin or Senate Energy and Natural Resources Committee Chairman Jeff Bingaman (D-N.M.) delayed the start of the conference for several weeks. Bingaman said Tauzin would "work fairly with the Senate to make sure the conference doesn't become a political exercise." The conferees will have to resolve major differences, including a House provision not in the Senate bill opening the Arctic National Wildlife Refuge to leasing.

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### CALIF. ISO: MERCHANT INDUSTRY'S FINANCIAL WOES LED TO CANCELLATION, DELAY OF NEARLY 1,800 MW

The merchant power industry's financial problems have prompted developers to cancel or postpone indefinitely nearly 1,800 MW of generation under development in California, leaving the state with only a fraction of the new capacity it had expected to be on-line by June 1, the Independent System Operator told federal regulators.

In addition, the ISO said more than 2,000 MW of aging capacity in Southern California alone may be retired by the end of this year because of environmental regulations. If that occurs, the state would lose 1,400 MW more than the 653 MW the ISO had earlier forecast would be retired. The grid operator's assertions were contained in its fourth quarterly report submitted to the Federal Energy Regulatory Commission last Friday.

"Another significant change since the last report has been the dramatic decline in the amount of new generation resources that previously were expected to come on-line in the past two months," the ISO said. "Between April 15, 2002, and June 1, 2002, only 100.5 MW out of an expected 1,988 MW of viable new generation has been brought on-line."

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### ENERGY TRADING WILL CONTINUE, BUT BETTER UNDERSTANDING OF SECTOR NEEDED: ANALYST

Despite the current crisis of confidence sweeping the industry, "energy trading is still a viable business," Houston-based analyst Carol Coale said in a preliminary report Wednesday. However, "we believe that a recovery is unlikely until regulators, politicians, credit-rating agencies and shareholders gain a better understanding of the trading business," Coale cautioned

In a preview of a comprehensive report on the merchant energy sector to be released next week, Coale said "at the very least, marketers create liquidity and provide financial products and services." However Coale, a Prudential Securities equity analyst, and her associates expect dramatic changes in the way merchant companies do business from now on, in large part because investors and rating agencies will expect it.

'We are sensing that the 'new' trading environment will resemble that of

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### DYNEGY REDUCES GLOBAL WORKFORCE 6%, HOUSTON HEADQUARTERS, INCLUDING TRADING UNIT, HIT HARD

Hours after it said it was replacing Chief Financial Officer and Executive Vice President Rob Doty with energy marketing executive Louis Dorey, Dynegy Wednesday announced "targeted" layoffs that would hit the company's Houston headquarters' operations the hardest.

In a release issued after the market closed, the company said the cuts are part of its "ongoing strategy to execute business and financial initiatives to address current market conditions and generate cost savings." Some 340 employees throughout the company, representing about 6% of Dynegy's global workforce, are affected.

In Houston, 300 employees, including about 50 employees from the company's trading business, or about 15% of Dynegy's workforce in the city, were laid off. The company said the job cuts, along with attrition and

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retirements, are expected to save $35-million a year.

Two other energy companies—Pennsylvania-based PPL and Indiana-based NiSource—yesterday also announced significant layoffs. (See related stories below.)

"Dynegy has always been an efficient organization, especially from a workforce standpoint," said CEO Dan Dienstbier. "Nevertheless, the new business environment in the merchant energy sector requires that we pare down certain businesses, such as power trading, and adjust accordingly in order to position the company for long-term, sustainable profitability."

Dynegy said it would continue to take steps to enhance its financial position, strengthen its balance sheet and improve its credit profile.

Doty's departure is the latest change in the company's executive suite that began last month, when Dynegy announced the resignation of former CEO, Chuck Watson.

Following the latest personnel change, Dynegy's stock closed Wednesday at $7.71, down 99 cents or about 11.4% from Tuesday's close.

Doty joined Dynegy in 1991, and previously served as senior vice president of finance, vice president and treasurer, and vice president-tax, before being named CFO in 2000.

The company called Dorey's appointment "consistent with Dynegy's continued focus on enhancing its financial position, strengthening its balance sheet and improving its credit profile."

Dorey most recently served as president of Energy Marketing and Origination at Dynegy. Prior to that assignment, he was executive vice president of Strategy and Planning for Dynegy Marketing and Trade.

"Our business environment calls for a different set of skills as we address the changes in our industry," Dienstbier said in a statement. "Louis has a unique combination of commercial and financial knowledge and experience that will serve Dynegy and its stakeholders well as we structure our future."

Christopher Ellinghaus, an analyst with Williams Capital Group, expressed surprise at the selection of Dorey, whose previous experience had been in the trading segment of the business. " He's never been a CFO and never been a big finance guy in the past," he said.

"It was suggested that Dynegy needs a different skill set. I'm a little curious of what skills the trading person brings to the CFO job that the CFO doesn't, " Ellinghaus said. "They're sort of running out of executives at Dynegy."

In recent weeks Dynegy had come under fire for several financial decisions, including engaging in so-called "wash trades," that do not appear to have any purpose other than inflating the company's trading volumes, and Project Alpha, a controversial gas supply transaction, which also lessened Dynegy's tax exposure.

Ellinghaus said Doty's resignation might have been the result of these problems. "One wonders if Project Alpha wasn't the reason for it," he said, suggesting that Doty might have been the victim of fallout from decisions made by others in the company. "I'm not sure who's to blame for Project Alpha but I'm not sure it's Rob Doty."

William Maze, an analyst with Banc of America Securities, said Dynegy timed the announcement to coincide with its proposed layoffs and restructuring. "We knew and liked and had confidence in Doty, but we had believed through Dynegy's troubles that it would be difficult for him to survive," he said.

"They're replacing him with someone we know," Maze said. "Dorey has been visible to [Wall] Street."

Maze said he does not believe that the announcement indicates there are any more unresolved issues within Dynegy. "This is not a result of finding some other noise within the company," he said. "There [are] no more shoes to drop."

## PPL TO CUT 7% OF WORKFORCE, ABOUT 600 JOBS, AS PART OF PLAN TO SAVE $50M/YEAR

PPL Corp. said Wednesday that it would cut about 600 jobs, or 7% of its workforce, as part of a "productivity enhancement" program that should save the Allentown, Pa., company $50-million a year in operation and maintenance costs.

CEO William Hecht said "technological advances and new work processes" would improve the quality of service to PPL customers. As the number of employees is reduced, a spokesman said the company is installing a system for automatic meter reading that will cover its 1.3 million customers

Many of the affected employees—285 managers and 313 bargaining unit, or hourly wage, employees—are expected to take advantage of special retirement provisions, the company said. These involve incentives for early retirement down to age 50, including severance and placement help, but full details have not yet been released, the spokesman said. CEO Hecht stressed that the cuts will not affect "key" service positions, including linemen, electricians and line foremen.

PPL expects costs related to employee severance to run about $75-million. That will be recorded as a non-cash charge against PPL's second-quarter earnings. It is a non-cash charge because the funds will come out of the pension plan trust, not booked as operating expenses, the spokesman said.

This move follows the company's decision early this year to cancel about 900 MW of power projects under development in Pennsylvania, which will save about $1.3-billion in capital spending.

## NISOURCE LOOKS TO SAVE $1B THIS YEAR, PARTLY BY CUTTING UP TO 800 POSITIONS

NiSource, the parent company of Northern Indiana Public Service, plans to slash debt by at least $1-billion this year, partly through an ongoing, but previously unannounced, workforce reduction of up to 800 employees.

Gary Neale, chairman and CEO of the Merrillville, Ind.-based company, disclosed NiSource's debt and workforce reduction targets during a Bank of America conference in New York, and a company spokesman shed further light on Neale's remarks Wednesday.

NiSource has been saddled with debt since acquiring Columbia Energy Group of Herndon, Va., for about $6-billion two years ago.

According to the NiSource spokesman, the job cuts will affect all of the company's subsidiaries, including NIPSCO, Indiana's second-largest electric utility and largest natural gas utility.

NiSource hopes to hit its job-reduction target of 600 to 800 positions through normal attrition, planned retirements and a voluntary separation offer, but will resort to dismissals if necessary. The workforce cuts began late last year and will extend through the first quarter of 2003.

Currently, NiSource has about 10,000 employees.

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## ENVIRONMENTAL GROUPS CHARGE EPA 'KNOWINGLY UNDERMINED' NSR SUITS

The Environmental Protection Agency has "knowingly undermined" pending lawsuits brought in the late 1990s under the Clean Air Act's New Source Review in changes the agency has recently proposed to the program, a coalition environmental and health groups claimed Wednesday. They promised lawsuits to block the changes.

Calling EPA's June 13 NSR proposals "subtle yet devastating," the coalition unveiled a television advertising campaign aimed at getting the Bush administration to cancel its plan to finalize rules streamlining NSR. It hopes the ads will spur the White House to reverse its position or at least force EPA to analyze the potential effect on air pollution before making any changes to NSR. The ad campaign, launched yesterday in media markets in Houston, Philadelphia, Washington and Manchester, N.H., will run for one week.

"We will eventually be fighting the Bush administration in court, but first we will fight in the court of public opinion," Frank O'Donnell, executive director of Clean Air Trust, told reporters in Washington, D.C.

Natural Resources Defense Council senior attorney John Walke said EPA's proposal—particularly its plan to clarify what constitutes "routine maintenance"—will damage the agency's lawsuits against utilities for alleged illegal power plant modifications in the late 1990s. Walke said EPA's statement that it intends to clarify the definition of "routine maintenance" could prompt lawyers for the Tennessee Valley Authority, currently engaged in one of the NSR lawsuits brought by the government, to call for dismissal of the case. EPA "knowingly undermined those enforcement cases" by announcing it will clarify that definition sometime in the future, said Walke.

EPA said last week that its proposed changes would not affect those cases, which Administrator Christie Whitman said would be prosecuted aggressively. Whitman said no judge would let utilities off the hook for violations years ago based on changes offered this year.

Walke also argued that the proposed reforms, which EPA says would make NSR more effective and bring about greater reductions in industrial pollution, would also hurt settlement discussions that utilities have entered into to avoid litigation.

NRDC, joined by other national environmental groups and health advocates, urged EPA to analyze the potential effect of NSR changes on air pollution before making any regulations final. Walke said the administration has "refused to do so," fearing the study would find the changes will raise pollution levels. The "inevitable" poor result, he said, would cause political problems for the administration. EPA's top air official contended last week the agency's changes will bring significant emissions reductions.

Because the EPA reform proposals come in two packages and will advance on separate tracks, the environmental groups see at least two opportunities to sue the administration, said Walke. "Whenever anything becomes final—like a final issuance of a guidance or a final rulemaking—we'll be prepared to sue," he said.

New Jersey Gov. James McGreevey and the state's two senators this week said the state was committed to use "every means" to challenge the proposed NSR changes.

McGreevy and Sens. Jon Corzine and Robert Torricelli, all Democrats, said the proposed changes would allow more pollution from power plants upwind of the state, which eventually would harm New Jersey's environment and the health of its citizens.

"These out-of-state polluters contribute more than one-third of the pollution impairing New Jersey's air quality," McGreevey said. "The federal proposals would allow utilities that have broken the current rules to avoid cleaning up dirty power plants forever, while more and more New Jerseyans suffer." New York Attorney General Eliot Spitzer vowed last week to sue the EPA over the rules. Connecticut Attorney General Richard Blumenthal Tuesday said he will join that lawsuit.

## LA. CLAIMS FERC OVERREACHED IN CASE FORCING STATE UTILITY TO EXPLAIN RTO STATUS

The Louisiana Public Service Commission is claiming that federal regulators exceeded their jurisdiction when they ordered an American Electric Power subsidiary to show why it should not join a regional transmission organization.

In a June 17 rehearing request, the PSC said the Federal Energy Regulatory Commission violated the Federal Power Act when it directed AEP's Louisiana affiliate Southwestern Electric Power to either join the provisionally approved Midwest Independent Transmission System Operator and Southwest Power Pool merger or explain why it shouldn't (ER02-1420).

FERC issued the order May 31 as part of its approval granting the MISO-SPP combination status as a regional transmission organization.

The Louisiana PSC, however, argued that FERC lacks jurisdiction to order SWEPCO to join the MISO-SPP grid operator, or any other RTO, without the state's blessing.

"SWEPCO must obtain the approval of the Louisiana Public Service Commission prior to transferring ownership or control of its transmission assets to any RTO, and such approval has not been obtained," the state commission told FERC.

Moreover, the Louisiana commission has a pending investigation into whether RTOs would be cost-efficient for its utilities, and until those studies are complete, the state is not ready to sign off on RTO participation.

"No utility was to be permitted to join an RTO until these studies were complete and the commission had analyzed the results," the PSC said. "Not only are those cost/benefit analyses not complete, but SWEPCO has asked for a 60-day extension from the June 17, 2002, filing date to submit its cost/benefit study. Under these circumstances, the Louisiana commission cannot authorize SWEPCO to join an RTO at this time."

At the same time, FERC has not demonstrated why SWEPCO should join any RTO in the first place, the state commission said.

"SWEPCO has 15 days to demonstrate why it should not join MISO, without ever having been provided evidence (or even conclusory statements) as to why it should join that RTO," the PSC said. "This improperly perverts the appropriate burden of proof, imposing on SWEPCO an impossible burden."

## FERC WANTS COMMENTS ON TIMELINE FOR SOLVING N.E., MID-ATLANTIC 'SEAMS' CONCERNS

The Federal Energy Regulatory Commission is seeking public comments on a timeline for resolving "seams" issues proposed last week by grid operators in the Northeast and

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Mid-Atlantic.

In an order late Tuesday, FERC requested that comments be filed electronically by July 10, before a second discussion of the timeline is held at the commission's July 17 open meeting.

The commission last week held a lengthy conversation with top officials from the PJM Interconnection, Midwest Independent Transmission System Operator, New York ISO, and ISO-New England on resolving the so-called "seams" issues that could keep the regions from developing an efficient transfer of power between the ISOs.

According to the timeline presented at the meeting, the seams between New York, New England and PJM should be fixed by December 2003, while the common market proposed between MISO, PJM and the Southwest Power Pool would likely be operational in late 2005.

At its upcoming public meeting June 26, the commission will hold a similar discussion with top officials from the former Alliance GridCo companies, which over the past few weeks have split up to join PJM and MISO.

## BILL FORCING NORTH CAROLINA EMISSIONS CUTS TO BE SIGNED INTO LAW THURSDAY

North Carolina Gov Michael Easley (D) on Thursday will sign into law the "clean smokestacks" bill, which calls for Carolina Power & Light and Duke Power to pursue nearly $3-billion worth of emissions-reduction projects at coal plants over the next 10 years, the governor said Wednesday. The bill was overwhelmingly approved by the state Senate on Tuesday.

Easley, CP&L, Duke and other parties in late April agreed on details of the bill. The legislation allows the two investor-owned utilities to freeze retail rates for five years to recoup the cost of the projects, which will include flue-gas desulfurization equipment—or "scrubbers"—as well as selective catalytic reduction and other emission-reduction devices.

The law will require the 14 coal plants owned by the IOUs to reduce their nitrogen oxide emissions by 2009 to levels 78% below their levels in 1998, and to reduce sulfur dioxide emissions to 49% below 1998 levels by 2009. and 74% by 2013.

Unlike federal air quality rules, the law will require CP&L and Duke to reduce emissions in North Carolina all year, not just during the April-through-October ozone season. The new law also allows the IOUs to buy or trade pollution credits from other sources within North Carolina.

Finally, the law will require the North Carolina Division of Air Quality to study mercury and carbon dioxide emissions in the state. Easley said the equipment to be installed to meet the requirement for $SO_2$ reductions is expected to roughly halve the amount of mercury emissions.

CP&L has said it expects to spend about $1.4-billion to comply with the law, Duke expects to spend about $1.5-billion.

## PEPCO-CONECTIV DEAL CLEARS LAST BIG HURDLE WITH N.J. OKAY; ONLY SEC LEFT

The New Jersey Board of Public Utilities in Newark voted Wednesday to approve the merger of Potomac Electric Power and Conectiv, which operates utility Atlantic City Electric in southern New Jersey.

In its ruling, the BPU approved a settlement the companies had signed earlier with intervenors, requiring Conectiv to reduce by $30.5-million its "deferral balance." That refers to the losses that Conectiv has incurred since the start of deregulation by buying power in the market to serve customers at below-market, frozen rates. All of the state's utilities have booked losses and will be able to seek recovery when the competition transition period ends in mid-2003, and rates are unfrozen.

At the beginning of 2002, Conectiv had a New Jersey deferral balance of about $100-million.

The BPU vote is the last major approval the companies needed for the merger, which has already been cleared by the Federal Energy Regulatory Commission and regulators in Delaware, the District of Columbia, Maryland and Virginia. PEPCO and Conectiv now only require approval from the Securities and Exchange Commission.

Under the merger agreement, PEPCO will acquire Conectiv for $2.2-billion in cash and stock, creating a company with 1.8 million customers.

## CAROLINA UTILITIES SUSPEND GRIDSOUTH WORK UNTIL REGULATOR STUDIES ARE DONE

The three utilities behind the proposed GridSouth regional transmission organization Wednesday suspended most of their work to advance the RTO until state and federal regulators complete upcoming reports.

Carolina Power & Light, Duke Power, and South Carolina Electric & Gas said they would delay filing RTO applications with the North Carolina Utilities Commission and South Carolina Public Service Commission to give them "time to review the effects of regulatory initiatives that are beginning now and due for completion later this year."

A Duke Power spokeswoman said those initiatives include the Federal Energy Regulatory Commission's guidelines on a standard market design, which are due to be released by late July, and an RTO cost-benefit analysis study to be completed by the Southeastern Assn of Regulated Utility Commissioners by the end of the year.

"We continue to support the concept of a Carolinas RTO, that hasn't changed," the spokeswoman said. She added, however, that the FERC and SEARUC reports could significantly influence the form the RTO would ultimately take.

The proposed GridSouth RTO would have 22,000 miles of transmission lines connected to about 35,500 MW of generating capacity in the Carolinas.

## DOMINION VIRGINIA POWER ASKS FERC TO DISQUALIFY ITS QF SUPPLIER IN N.C.

Dominion Virginia Power is fighting efforts by a North Carolina cogeneration plant to retain its status as a qualifying facility under the Public Utility Regulatory Policies Act.

Panda operates a 180-MW gas-fired cogeneration facility in Roanoke Rapids, N.C., that sells output to Dominion Virginia Power's subsidiary Dominion North Carolina Power.

Panda last month asked the Federal Energy Regulatory Commission for a waiver of QF operating and efficiency standards in 2002 and 2003, and it applied for recertification as a QF.

Saying it "strongly opposes" Panda's recertification request, Dominion Virginia Power urged FERC to deny the

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requested waiver.

"The commission's QF regulations create a privilege, not a right," said Dominion Virginia Power. "Those facilities that do not meet the operating and efficiency standards should not be entitled to special treatment where the technology is conventional and the public interest is not served by granting a waiver."

Panda's current thermal host, Westpoint Stevens, has been taking a declining amount of steam, a development that has left Panda unable to meet operating and efficiency standards for the indefinite future. Panda has petitioned FERC for a two-year waiver of the standards while it establishes a business with Rosemary Water Corporation, to construct and begin operations of water distillation equipment. RWC proposes to sell the distilled water or bottle the water for retail sale. Panda expects RWC to begin operations by fourth-quarter 2002.

"Although Panda has only asked for a two-year waiver, the non-compliance and need for a waiver could well be for an indefinite period," the utility argued. Furthermore, Panda's application is not timely, it said. "The textile mill that purchases steam from Panda changed ownership in 1997 and then terminated its purchases of chilled water in 2000. In the same year, the takes of steam began to decline and will probably decline further because of the poor market for textiles," said Dominion Virginia Power. "Beginning at least in 2000 and perhaps earlier, Panda could have requested waivers, filed its power sales agreement with the commission, or found an alternative steam host."

In addition, Dominion Virginia Power argued that "Panda's gas-fired facility provides little in the way of conservation." Dominion said the facility only marginally exceeded the efficiency standard of 42.5% from 1998 through 2001.

## PEROT TO TESTIFY JULY 11 BEFORE CALIF. COMMITTEE ON MARKET MANIPULATION

Ross Perot, chairman of Perot Systems, will testify before California state Sen. Joseph Dunn's (D) select committee on wholesale power market manipulation July 11, a spokeswoman for Dunn said Wednesday.

Dunn, who has been leading an in-state investigation of the spot price run-ups of 2000 and 2001, has raised questions about a presentation given by Texas-based Perot Systems to energy traders about ways to increase profits in the state's market.

Perot Systems helped develop California's system for scheduling and managing power on the grid. In March 2000 the company signed a $35-million contract for information technology services with the California Power Exchange, which has since gone out of business. Last week a spokeswoman for the Texas businessman said Perot received an invitation from Dunn to testify and "does anticipate going to California."

## S&P EXPECTS TO UPGRADE SEEBOARD FOLLOWING ACQUISITION BY LEG

Standard & Poor's Wednesday put American Electric Power unit CSW Investments and its SEEBOARD plc unit and related subsidiaries on CreditWatch—Positive, citing Monday's agreement for AEP to sell CSWI to higher-rated London Electricity Group. LEG's long-term debt was affirmed at A+ with a stable outlook.

S&P rates BBB+ the long-term debt of CSWI, SEEBOARD, SEEBOARD Energy and SEEBOARD Power Networks. It expects to equalize them at A+ following the acquisition.

"In S&P's view LEG's business profile will be marginally reinforced as an integrated utility following the acquisition," said analyst Jean-Francois Veron in Paris.

S&P also affirmed LEG parent Electricite de France's long-term debt at AA, but its outlook is negative due to large unfunded pension liabilities.

"S&P will also closely monitor the pace of EDF's acquisitions, the evolution of its credit protection measures, and the progress of any partial privatization, which will be the major drivers of the ratings," added Veron, joined by associate director Ana Nogales and associate Rachel Goult, in London.

## WESTERN RESOURCES RENAMED WESTAR

Western Resources on Wednesday officially changed its name to Westar Energy, an action approved by shareholders at the company's annual meeting.

The new name reflects the trade name under which the company's two electric utilities, KPL and KGE, have been serving their 640,000 Kansas customers for more than a year.

Westar, headquartered in Topeka, will not issue replacement stock certificates for holders of certificates in the names of Western Resources or The Kansas Power and Light Co. Those certificates will represent the same number of shares of Westar Energy. Future stock certificates will reflect the new name, but the NYSE trading symbol will remain WR.

## S&P CUTS MOST RATINGS ON CINERGY AND ITS UTILITY OPERATING UNITS

Standard & Poor's Wednesday downgraded the corporate credit and senior unsecured debt ratings of Cinergy's utility units, reflecting S&P's assessment that the risk of default is the same throughout the consolidated companies, so ratings should be levelized.

The utilities' senior secured was affirmed at A- due to the significant value of the property backing the first mortgage bonds, said S&P Associate Director Deborah Kaylo.

S&P cut the corporate rating of Cincinnati Gas & Electric and PSI Energy from A- to BBB+, at which Cinergy's corporate rating was affirmed. The holding company and utilities' senior unsecured was cut from BBB+ to BBB, and the utilities' preferred stock from BBB to BBB-.

All ratings were taken off CreditWatch—Negative and outlooks are now stable.

"Importantly, ratings are based on Cinergy's strategic focus to continue operating as a virtual fully integrated utility. Any deviation from this strategy would pressure its business and financial profiles. Ratings are constrained by Cinergy's higher-risk, nonregulated activities, including energy trading and marketing. The stable outlook expressly factors in Cinergy's commitment to bolster its balance sheet, improve credit protection measures, and operate as an integrated utility," added S&P. "Failure to make

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significant progress in a timely manner will pressure ratings."

## DWR PROJECTS NEARLY $110M IN EARNINGS FROM OFF-SYSTEM POWER SALES NEXT YEAR

The California Dept. of Water Resources said it expects to earn nearly $110-million next year by selling excess contract power off-system.

At a presentation to utility and state officials Wednesday in Sacramento, the state agency said predicted off-system sales next year of 8,388 MWh at a selling price of $12-$14/MWh. Off-system sales, DWR said, are likely to account for nearly 17% of the 50,399 MWh the agency expects to receive next year through long-term contracts it signed last year.

DWR is able to make off-system sales when its power delivered under the contracts is not needed to meet the so-called "net short" position of the state's three investor-owned utilities. The agency uses the money to offset the revenue it collects from utility ratepayers.

At yesterday's conference, DWR detailed its revenue requirement for 2003, which calls for $4.69-billion to pay for power and $840-million to begin paying off a revenue bond the state has yet to issue. The agency plans to file its request with the California Public Utilities Commission by July 10.

In its presentation, DWR said its off-system sales are likely to be higher than those made this year and last, when sales for the two-year period totaled $46-million, considerably less than the $156-million the agency had projected.

DWR Consultant Frank Perdue said the revenue was lower in 2001 and 2002 because it was offset by the agency's spot-market purchases and the fact that the company was forced to sell some of the contracted power at a loss.

## CALIF.-WOES *(continued from page 1)*

The ISO blamed the "alarming trend" on "financial difficulties facing new generation developers."

The report added that since April 15, developers have cancelled, withdrawn or postponed indefinitely some 1,771 MW of generation. Much of the remaining new capacity the ISO still expects to come on-line this year has been delayed past June 1, the report said. San Jose-Calif.-based developer Calpine Monday brought on-line its 880-MW Delta Energy Center in Pittsburg, Calif.

The latest report is far more pessimistic than the ISO's 2002 Summer Assessment, which was released May 15. In that report, the ISO forecast 2,961 MW of new generation would be in operation before June and stated that operating margins for the summer season would be "significantly higher than recent years."

The ISO noted that California has managed to avoid problems because of mild weather and brisk hydroelectric production in the Northwest. "California's good fortune largely can be attributed to merely transitory supply and demand conditions," the report said. "Mild weather, a weak economy and conservation have been instrumental in keeping loads manageable."

The ISO attributed the downturn in generation development to lower energy prices, fallout from the Enron bankruptcy and regulatory hurdles. "Accounting difficulties, credit downgrades and the heightened regulatory scrutiny generation owners have received of late has made new generation development even more difficult, as evidenced by the volume of cancelled capacity between April and June 2002," the report concluded.

FERC last September asked the ISO to supply quarterly updates on the state's progress in developing new generation.

Gary Ackerman, executive director of the Western Power Trading Forum, which represents generators and marketers, agreed with the ISO's assessment and said the cancellation or postponements of new plants may mean the state is headed for trouble.

Ackerman said the dearth of peaking plant development is the biggest problem, adding peaking facilities have difficulty turning a profit under the capped prices.

"Under the West-wide price cap there is absolutely no incentive for anyone to build a peaker, and if that price cap isn't released Sept. 30, this trend will continue," Ackerman said.

The lack of new generation and the likelihood of higher-than-expected capacity retirements have also led a number of forward power traders in the West to predict that California and other parts of the West could again find themselves short of generation. Although the market currently has more power than it needs, traders said the state could next year see a repeat of market conditions in 2000 and 2001 when tight supply caused prices to soar.

The traders added, however, that any new shortage would likely be less severe than in the last two years because buyers have hedged better than they did in the past and have bought more power in forward markets.

One trader downplayed the ISO's alarm, saying the reason for the delay in new generation additions is likely due to economic reasons. Demand is low and prices in the spot and daily markets are weak. He said it would not make sense for the new generators to work overtime to get plants running when there would possibly be no profit in it.

## ENERGY-TRADING *(continued from page 1)*

the early 1990s, characterized by buying and selling arrangements under shorter-term durations before the excessive use of structured deals, long-dated books and complex financial transactions," she said.

Yet that presents a new set of potential problems. "While credit rating agencies and investors are currently endorsing short-dated books, the potential returns on the shorter transactions are low, and achieving competitive advantages is difficult, in our view," Coale said. "A too short-term trading focus could lead to glamorized day trading with less control over profit potential." She added that longer-term transactions "are not necessarily a bad thing—if strict risk controls are in place."

Energy trading operations will likely undergo "substantial consolidation over the next few years," Coale said. "Not just to gain financial strength, successful trading partners will likely need scale to make required substantial investments in controls, information technology...compliance architecture, and in highly skilled personnel. We believe these criteria require appropriate capitalization, corresponding credit rating and a high degree of risk tolerance on the part of both companies and shareholders."

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With potentially high operating leverage and expensive operations, the scale and efficiency of gas and power trading "will likely become more important," she said. "However, the measurement of scale—traditionally volumetric—may take on a new definition following the abuse of so-called 'wash' trading."

Coale said investor scrutiny of the energy merchants has been "amplified by the overcorrective measures taken by the credit-rating agencies, which we believe are largely to blame for the horrendous stock performance in the energy merchant sector" over the past 12 months.

"We believe the ratings agencies, to avoid regulation of their own business, have taken on a policing role toward the merchants. However, the agencies have 'clubbed' many of the merchants with credit ratings downgrades before balance-sheet restructuring initiatives are complete."

Coale said the risk of further ratings downgrades "has not only impaired the energy trading business but also sent investors to the sidelines. Several energy merchants have succumbed under the rating agency mandates to either downsize, spin off or joint venture their trading operations" or face the risk of losing investment-grade rating status.

And that may hamper the sector's recovery, she cautioned. "We believe successful energy trading operations require enormous capital, which raises the question of the viability of scaled-back trading operations" such as those recently downsized by El Paso, Aquila, Dynegy and Williams.

"We believe there are a few critical competitive advantages needed in energy trading, especially in the generation of recurring earnings streams," the report said. "However, there appears to be a paradox between what it takes to be a good energy trading company and the metrics that Wall Street uses to value energy trading operations. From an operational standpoint, the ability to originate large, complex and/or long-dated deals are key metrics in establishing a leading trading business, in our view. Unfortunately, those same characteristics seem to be receiving the largest valuation discounts from Wall Street."

But Coale also placed blame on the industry for its recent spate of embarrassments. "We believe the lack of financial disclosure and the secrecy surrounding contract terms make this business opaque to the outside observer," she said. "Also difficult to assess is the charge for risk capital in addition to explicit charges for interest associated with cash collateral and other credit backing mechanisms that are unique to the trading business, in our view."

Based on a "quantitative proprietary ranking system," Coale said the "best positioned energy traders" going forward include Duke Energy and El Paso.

**AES-FREEZE** *(continued from page 1)*

the main strategic focus, he said, adding new growth will come later.

The company will especially look at strategic alternatives for its holdings in Brazil and the rest of Latin America, and will consider sell-offs or spin-offs of assets in that region, he said.

Hanrahan also said AES will increase its cost-cutting goal above the current $200-million a year, but did not set a specific new target. AES will take a much more disciplined approach to future investments, he said.

According to Hanrahan, initial discussions with ratings agencies about the new plan have been positive, and AES is committed to improving information for its investors. For a start, AES executives will hold a road show this summer to explain the plan.

Also at the briefing, departing CEO Bakke took responsibility for the "terrible" economic leadership of AES over the last year and said Hanrahan would bring more "discipline, accountability, control and efficiency" to the company.

Bakke said he had been considering stepping down since last September when AES stocks plunged after bad earnings news. Now that the company has begun its recovery effort, he said he believes it is an "acceptable" time to leave.

Also Wednesday, Standard & Poor's downgraded from CC to D the rating on a $110-million bank loan taken out by AES Ocean Springs Ltd., a unit that indirectly controls two Argentine distribution companies. Empresa Distribuidora de Energia Norte S A (EDEN) and Empresa Distribuidora de Energia Sur S.A. (EDES).

Bank loans by EDEN ($23-million) and EDES ($67-million) were also cut from CC to D, S&P's lowest rating category, reserved for issues in default. The utilities did not repay the loans, which were due Tuesday, nor did Ocean Springs cancel an $8.5-million bank loan amortization, also due Tuesday, said S&P.

"The financial performance of EDEN and EDES has been substantially eroded as a result of the pesification [of Argentine dollar-denominated debt] and freeze of tariffs, without allowing for any kind of compensating adjustments, combined with the strong and continuing devaluation of the peso, which followed the end of convertibility [into dollars]," said associate Sergio Fuentes, and director Lidia Polakovic, in Buenos Aires.

**ENERGY-BILL** *(continued from page 1)*

Meanwhile, Rep. Joe Barton (R-Texas) said yesterday he would support efforts to add language during the conference to expand Federal Energy Regulatory Commission authority to impose civil and criminal penalties on energy traders found guilty of manipulating the market to increase prices.

Barton, who chairs the House Energy and Air Quality Subcommittee, spoke to reporters a day after the General Accounting Office released a report charging that FERC has failed to adequately oversee the wholesale energy market's transition to competition and that it lacks significant authority to penalize wrongdoers.

"We have no definite proposals yet, but we are working to come up with an appropriate mechanism. We will consider it in the energy bill conference," which will begin June 27.

Barton said he also would back efforts to include provisions in the energy bill designed to prevent a repeat of Enron-like practices in the energy markets. "I would support some reforms in terms of open markets and transparency." He also said he supports legislation introduced late last month by Oregon Republican Rep. Greg Walden that would outlaw so-called "wash trades."

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MONEY & INVESTING
THE WALL STREET JOURNAL.
TUESDAY, AUGUST 27, 2002 C1

# Private-Equity Firms Court Energy Industry

## Power Concerns Needing Cash Fast Are Looking to Part With Assets That Deregulation Made Appealing

By Kathryn Kranhold

WARREN BUFFETT LED the way. Now, a number of big private-equity investors are taking a close look at the energy industry in the hopes of picking up potentially lucrative assets on the cheap.

In recent weeks, deep-pocketed firms such as David Bonderman's Texas Pacific Group, the Blackstone Group, Boston's Thomas H. Lee Partners, and Chicago's Madison Dearborn Partners and Apollo Advisors LP have begun analyzing the financial prospects of power plants and pipelines, people familiar with the situation say.

The assets belong to a slew of power companies laid low by the collapse of the merchant energy market in the wake of industry pioneer Enron Corp.'s filing for Chapter 11 bankruptcy protection in December. Many power companies borrowed heavily to expand into the merchant power business of generating electricity that is sold at market prices to utilities, which resell the power to their customers. But, hit by credit-rating downgrades and a cash crunch from lower power prices, as well as a steep decline in electricity and natural-gas trading, companies are looking to sell assets so they can raise cash and stay alive.

DEALS & DEAL MAKERS

So far, few deals have been cut, in large part because buyers and sellers still remain far apart on price. But interest is picking up in the wake of a couple of big-ticket purchases by MidAmerican Energy Holdings Co., which is part-owned by Mr. Buffett's Berkshire Hathaway Inc. In the most recent of these, MidAmerican closed a deal to buy Dynegy Corp.'s Northern Natural Gas pipeline subsidiary for about $1.8 billion in cash and debt.

Private-equity firms haven't typically been big players in the power industry, which traditionally has offered low returns, required huge amounts of capital and has been heavily regulated. But with the advent of deregulation in the mid-1990s, the energy industry started taking on some characteristics that make it more attractive to private-equity investors.

David Gothard

### For Sale: Power Plants and Pipelines

Energy companies, facing cash crunches, are putting assets on the market, quickly in some cases.

| COMPANY | LOCATION | ASSET |
|---|---|---|
| Duke Energy | Charlotte, N.C. | Empire Pipeline |
| El Paso | Houston | Power plants |
| Mirant | Atlanta | Power plants and 49% interest in WPD, a British electric utility co-owned with PPL Electric Utilities |
| FirstEnergy | Akron, Ohio | Power plants |
| CMS Energy | Dearborn, Mich. | Panhandle Eastern Pipe Line Company |
| Aquila | Kansas City, Mo. | 79.9% stake in Avon Energy Partners Holdings Co., owner of British electric utility Midland Electricity |

Sources: Companies and financial sources

During that period, electric companies and their unregulated subsidiaries roamed the globe buying and building power facilities to show Wall Street that they, too, could be growth companies like their telecom and Internet counterparts. Attracted by the prospect of higher returns, Goldman Sachs Group Inc. pushed into the merchant power market, forming Orion Power Holdings in 1998. Last year, it sold the company to Houston's

Please Turn to Page C5, Column 1

# Equity Firms Examine Energy

Continued From Page C1

Reliant Resources Inc. for $2.9 billion.

Kohlberg Kravis Roberts & Co. also dipped into the business, investing in 2000 in DPL Inc., a Dayton, Ohio, electric utility and merchant energy. The firm partially cashed out last year.

But KKR and Goldman haven't had a lot of company—until now. In recent weeks, merchant energy companies such as Dynegy, Mirant Corp., Aquila Energy Inc. and CMS Energy Corp. have begun announcing they want to sell assets. The list of assets for sale ranges from a majority stake in British utility Midland Energy that Aquila put on the block after buying it in May to Duke Energy Corp.'s Empire Pipeline in western New York. Empire, a 150-mile pipeline, was part of Duke's $8 billion acquisition of Westcoast Energy Inc. this year.

"Marketplace inquiries have led us to begin evaluating outside interest in the Empire Pipeline. As with any asset, we're willing to consider offers from those whose valuation of the system might be greater than ours," says Duke spokesman Terry Francisco, though he adds that this doesn't signal any big Duke sell-off.

Pipeline firm El Paso Corp. is expected to sell a significant portion of its 4,000 megawatts of merchant power plants; the plants are in a special-purpose vehicle called "Project Electron," which the company is currently looking to unwind, say people familiar with the situation. An El Paso spokesman declined to comment.

All together, some energy analysts predict that plants with generating capacity totaling as much as 100,000 megawatts, or about one-eighth of the country's power supply, could be unofficially up for grabs as companies such as AES Corp., Calpine Corp. and Mirant look to raise cash to strengthen their balance sheets. "Merchant generators born into a bull market used excessive leverage and now must manage through a down cycle," says Michael Johnson, a banker with Deutsche Bank AG.

This means opportunity for the private-equity firms, and possible much-needed capital for energy companies. "The financial firms can provide an important source of capital in a market that currently has a lack of liquidity and needs more capital," says Jeff Holzschuh, who heads the global energy group at Morgan Stanley.

Power companies have little choice but to seek private-equity these days says Erroll Davis Jr., president and chief executive of Alliant Energy Corp., which owns electric utilities and has a merchant power subsidiary that is seeking to buy assets from other firms. Mr. Davis says his finance people "are leaving no stones unturned" in looking for new sources of funding, including private-equity firms, because "other sources are drying up."

Still, energy companies are reluctant to part with their assets at a price the private-equity firms seem to be willing to pay. Financial analysts say many energy companies would sell a plant or pipeline if they could get 80% of the replacement value. Potential buyers, however, are hoping to pay only about 50% of replacement costs, says Mr. Johnson of Deutsche Bank. The reason more deals haven't been done is that, in many cases, the lower price wouldn't cover the debt used to finance the plant, he adds.

In the meantime, private-equity shops, which don't have the trading and risk-management capabilities to run a group of power plants, are scouting for managers who have the skill to do the job. People familiar with the discussions say some firms are moving toward backing a handful of management teams. For example, Michael Polsky, who previously sold an independent power company SkyGen Energy to Calpine for $550 million plus debt, has formed a new energy investment firm called Invenergy LLC that has raised private equity to invest in the industry.

No one expects a rash of plant sales anytime soon. Both private-equity firms and Wall Street financial institutions are still waiting for the prices to drop further.

Mr. Johnson predicts plant owners will "resist selling until liquidity concerns override" the long-term cash value of the plants. He says some owners may sell a portion of their assets to "preserve the upside" on the remaining assets.

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*Atlanta Journal and Constitution December 21, 2001, Friday*


Atlanta Journal and Constitution

**December** 21, 2001, Friday

**KR-ACC-NO:** AT-MIRANT

**LENGTH:** 810 words

**HEADLINE:** Mirant Sells Stock after Downgrade

**BYLINE:** By Matthew C. Quinn

**BODY:**
Mirant Corp. scrambled Thursday to raise $ 759 million in hopes of bolstering investor confidence.

The company, stung by a credit rating downgrade a day earlier, sold its own stock as part of a plan to cut costs and sell assets.

"My management team takes the current situation very seriously," Marce Fuller, Mirant's chief executive, said in a conference call with Wall Street analysts.

"We are taking significant steps to strengthen our balance sheet and create value for our shareholders," she said. "We have a plan that works and should not require us to access the debt and equity capital markets during 2002." Moody's Investor Service downgraded Mirant's credit rating to "junk" status Wednesday over credit concerns. It was the latest setback for the independent energy sector since the Dec. 2 bankruptcy filing by industry leader Enron Corp.

Atlanta-based Mirant, which had been briefing Moody's on its financial plan, was surprised and "extremely disappointed" by the move -- and given no opportunity to respond to the decision, said Chief Financial Officer Raymond Hill.

Mirant executives, working through the night at the firm's Perimeter Center headquarters, hammered out plans to sell 40 million more shares of stock. The stock issue wound up selling 60 million shares and raising $ 759 million.

Mirant stock, which had lost almost half its value this month, dropped by nearly 13 percent Thursday, falling $ 2.08 to $ 13.99, partly due to the dilution of shares by the massive stock sale, analysts said.

Standard & Poor's reaffirmed Mirant's investment-grade credit ratings Thursday while Fitch Investor's Service put the entire independent power sector on negative credit watch in more fallout over Enron's failure.

Mirant said the Moody's downgrade did not trigger any early loan repayments of the sort that pushed Enron into bankruptcy. But the downgrade will require the company to come up with up to $ 700 million to finance its energy trading operations.

Hill said Mirant officials will meet with Moody's analysts next month and hope for a "constructive dialogue" on restoring the company's favorable ratings.

"It's clearly a positive thing that the company has sold stock today," said Andy Jacobyansky, vice president/senior credit officer at Moody's. "We need to analyze how this will affect the company's cash flows before we decide to take any action in response."

Mirant reported a "positive reaction" to its announcement from the investment community and plans another conference call today.

"I think they'll come out OK, unless they are downgraded by the other agencies," said Williams Capital analyst Chrisopher Ellinghaus. "Mirant will still be up there at Perimeter Center for years to come."

Mirant also said it was reducing its 2002 capital budget 40 percent from $ 4.1 billion to $ 2.6 billion and selling off "non-strategic assets" to raise $ 1.6 billion. That includes $ 900 million from a previously announced sale of Mirant's stake in a German power company.

Mirant expects to have $ 4.8 billion in cash and available credit through the end of next year, presuming a planned **purchase** of a natural **gas plant** in Puerto Rico from an Enron partnership falls though as appears likely. That projection did not include proceeds from Thursday's stock **sale.**

Mirant said it will proceed with construction of U.S. power plants representing 5,700 megawatts of electric power generating capacity by August 2003 but will cancel or defer construction on 10 new U.S. projects the company did not identify. The company also "does not plan any layoffs at this point," added Sean Murphy, vice president and treasurer. Mirant has 10,000 employees worldwide, including 1,200 at its Sandy Springs headquarters.

But Mirant scaled back its future growth projections from between 20 percent and 25 percent per year to between 10 percent and 15 percent.

Mirant still expects to earn $ 1.95 per share this year, before a newly disclosed one-time pretax charge of up to $ 111 million in the fourth quarter for dealings with Enron in the **United States** and Britain.

But the company now expects $ 110 million less in profits next year and scaled back its earnings projections of between $ 2.55 and $ 2.65 per share to between $ 2 and $ 2.10.

Mirant's plunging stock price and attractive earnings stream has even prompted talk of a possible takeover of the one-time Southern Co. subsidiary. "The whole sector is a takeover target," Ellinghaus said.

But Murphy said rival companies "are dealing with the same problem" as Mirant. "Their shares are down, too. Nobody has the currency to go on an acquisition binge."

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*Weekly Petroleum Argus May 20, 2002*


Weekly Petroleum Argus

**May** 20, 2002

**SECTION:** No. 19, Vol. 32; Pg. 11; ISSN: 0286-7844

**IAC-ACC-NO:** 86504454

**LENGTH:** 369 words

**HEADLINE:** Dynegy hints at restructuring; US corporate; Brief Article; Statistical Data Included

**BODY:**
Beleaguered US energy merchant Dynegy this summer will announce sweeping changes to its business portfolio, chief executive Chuck Watson told investors last week.

The changes aim to pay down debt and meet tougher credit standards imposed by financial markets since Enron's collapse. The Houston-based company has been examining "every asset, every plant, every business" and will choose which to jettison to help restore company finances, Watson said. "The bar has been raised and we have to restructure our company to compete." Watson denied his company recorded revenue from the "round-trip" trades made last November with CMS, He played down the film's trading business, saying it was not a "necessary" activity for the company.

In January, Dynegy announced $ 500mn of capital spending cuts, issued $ 750mn in new stock, and said it plans to sell $ 375mn of assets to an affiliated partnership. It also sold $ 1.5bn of bonds to ChevronTexaco to finance its purchase of Enron's Northern Natural Gas pipeline.

Taking these steps will not be easy for Dynegy, which under Watson has made dozens of acquisitions in the past 17 years, assembling $ 25bn in assets, including power **plants** with 18,900MW of capacity, **gas** pipelines and processing facilities. But like its peers, Dynegy may be forced to **sell** off a significant amount of valued assets.

Ratings agency Standard & Poor's (S&P) last week said Dynegy would have to put up $ 1bn in cash as collateral against trades should its credit rating be cut to "junk" status. S&P and Moody's are considering such a downgrade.

Watson remains defiant, despite the barrage of bad news and an 82pc decline in Dynegy's share price since mid-November. The recent surge in allegations about market manipulation is prompted by politics, he said.

"We've been under investigation for two years. Every document we have has been with [investigators]," he said. "There's nothing I've heard in the past three weeks that is new

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news."

The company has plans that will strengthen its balance sheet without requiring another infusion of capital from ChevronTexaco, Watson says. "ChevronTexaco has its own shareholders. I don't ask [it] to bail us out."

**IAC-CREATE-DATE:** May 31, 2002

**LOAD-DATE:** June 01, 2002



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THE WALL STREET JOURNAL.
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EARNINGS

# Williams Posts Loss as Weakness In Energy Trading Hurts Results

A WALL STREET JOURNAL ONLINE NEWS ROUNDUP

TULSA, Okla. -- **Williams** Cos. swung to a second-quarter net loss, weighed down by its energy-trading operations and charges for its former telecom unit.

The credit-crunched company, which has been doubly hit by telecom and energy-industry woes, on Monday reported a net loss of $349.1 million, or 68 cents a share, compared with net income of $339.5 million, or 69 cents a share, a year earlier.

Results for the 2001 period include a gain of $72.1 million for the sale of convenience stores, a gain of $27.5 million for the sale of its stake in Northern Border LP and income of $10.7 million from discontinued operations. Results also include charges for the impairment of assets, early retirement costs and accrued liability. Excluding all items, the company said it earned $280.1 million, or 57 cents a share.

The net loss for the latest quarter was in line with the company's forecast last week, when it warned that it would lose 63 to 73 cents a share in the second quarter because of constraints its credit problems have placed on its energy-trading business.

Excluding a one-time pretax charge of $246.5 million, Williams said it lost 34 cents a share, also in line with last week's forecasts, but down sharply from the company's earlier projections of earnings of 20 cents to 25 cents. The charge relates partly to pipeline projects that were scrapped and to its former telecommunications unit Williams Communications Group Inc., which recently filed for bankruptcy-court protection. Williams spun off the unit in April 2001. The charge also includes asset impairments and severance and early-retirement costs.

Williams also said it has delayed its quarterly conference call, originally scheduled for 10 a.m. EST Monday, until later this week. A company spokesman said that management has been occupied with the "liquidity issues" facing the company and that it made a decision to put off the conference call until additional information could be added to address the concerns.

**DOUBLY HIT**

- Williams Rating Is Cut to Junk[1] 07/24/02
- Williams Expects a Big Loss[2] 07/23/02
- Williams to End Ties to Former Unit[3] 07/17/02
- Williams to Lay Off 16% of Trading Floor[4] 06/24/02
- Williams Cuts 2002 Earnings Outlook[5] 06/11/02
- Energy Firms Deny Role in Manipulating Prices[6] 05/23/02
- Williams' Unit Seeks Chapter 11 Protection[7] 04/23/02

**COMPANIES**

Dow Jones, Reuters

Williams Cos. (WMB)

| | |
|---|---|
| PRICE | 1.30 |
| CHANGE | 0.24 |
| U.S. dollars | 10:23 a.m. |

* At Market Close

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Last week, the company said it was unable to renew a $1.2 billion unsecured credit line that expired Tuesday and said it would slash its stock dividend by 95% to a penny a share to save cash. Williams said at the time that it hoped to arrange a secured credit line of more than $1 billion within a week to 10 days.

The company's energy marketing and trading operations, posted a second-quarter loss of $497.5 million, compared with a profit of $262.2 million a year earlier. Williams blamed a significant decline in the mark-to-market value of its energy-marketing and trading portfolio because of a limited ability to exercise hedging strategies as market liquidity deteriorated. Williams also blamed increased credit and liquidity reserves, which reflect the deterioration of the energy-trading industry.

Williams' gas-pipeline group, which provides natural-gas transportation and storage services, reported a profit of $156.7 million, compared with profit of $181 million a year earlier.

Its energy-services unit, which provides energy products and services, reported a profit of $131.8 million, compared with profit of $263.9 million last year.

Williams, which has interests in pipelines, power plants and an energy-trading business, is trying to improve its balance sheet by about $8 billion through asset sales, spending cuts and equity issues after the collapse of Enron Corp. highlighted debt loads of other companies in the sector.

However, a credit crunch has prevented Williams from making new deals because it has to pay cash up front. Last week, Moody's Investors Service, Standard & Poor's and Fitch Ratings all downgraded their credit ratings on the company's debt to below investment grade, or "junk," status.

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*Updated July 29, 2002 10:35 a.m. EDT*



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platts

Friday, April 12, 2002

# Electric Power Daily



## California

### DORGAN TO ASK FERC FOR STATUS OF MARKET MANIPULATION INQUIRY

Saying he was "disgusted" by federal regulators apparent inaction up to now, Sen. Byron Dorgan said Thursday he would ask the Federal Energy Regulatory Commission to submit a progress report on its investigation into whether Enron or its affiliates manipulated spot prices in the electricity and natural gas markets in the West beginning in 2000.

The Democrat from North Dakota, chairman of the Senate Commerce Committee's subcommittee on consumer affairs, said that after California officials finished their testimony before the subcommittee yesterday, it appeared to him that FERC "exhibited very little interest or energy" in the western power markets. "FERC ought to be turning chairs over. We need to put a little pressure on them," Dorgan said.

In response to pressure from Congress and other corners, FERC in February started a fact-finding investigation into whether Enron or any other entity manipulated western gas and electricity markets beginning Jan. 1, 2000.

(continued on page 7)

## Power Market

### NYSEG SEEKS REHEARING OF ORDER GIVING STEELMAKER LOWER RATES

New York State Electric & Gas has asked the New York Public Service Commission to reconsider its order granting Nucor Steel a discounted electric rate contract. NYSEG President Ralph Tedesco this week called the contract an "obscene, sweetheart deal" that he said would prevent other ratepayers from benefiting by the company recent sale of some nuclear capacity.

Nucor, based in Charlotte, N.C., acquired a steel plant in Auburn, N.Y., from Auburn Steel. That company had been receiving discounted power, at 4 cents/kWh, under a state economic development plan meant to encourage new business. When Nucor took over the plant in 2001, it asked that the rate be continued, but NYSEG opposed the request, saying the company failed to qualify because was not opening or expanding a business. The PSC last month ordered NYSEG to sign a discount contract for the 44-MW load, citing the plant's

(continued on page 7)

### NEW YORK, CALIFORNIA SENATORS THREATEN TO BLOCK ENERGY BILL ON GASOLINE PROVISION

New York and California senators Thursday vowed to block the senate energy bill (S 517) unless a provision requiring the use of ethanol in gasoline is scaled back or deleted.

"We don't intend to let this bill go forward if we can prevent it," Sen. Dianne Feinstein (D-Calif.) said.

The move came on the same day the Senate came out in favor of setting up a consumer commission to examine price spikes in the electricity market. The Senate voted 69-30 for an amendment to the energy bill that would create a Consumer Energy Commission to study the causes of energy price spikes and make recommendations on how to avoid price spikes in the energy markets in the future.

Under the amendment offered by Sen. Dick Durbin (D-Ill.), the commission would be appointed on a bipartisan basis and be made up of

(continued on page 6)

### AEP EARMARKS $1B FOR POTENTIAL STRATEGIC ACQUISITIONS THIS YEAR TO BEEF UP EARNINGS

Columbus, Ohio-based American Electric Power Thursday said it was setting aside $1-billion for possible strategic acquisitions this year, but added that it is not necessarily looking to purchase another utility.

Linn Draper, AEP chairman, president and chief executive officer, told New York analysts that any acquisition "must fit our strategy," and said the asset would have to be profitable and add to AEP's earnings in the short term.

An AEP spokesman yesterday said the energy giant is not now contemplating a specific purchase. "It does not necessarily mean we're going to buy a utility," he said. An asset purchase could involve one or more power plants, a natural gas pipeline, or gas storage facilities, he said.

A combination of factors, including the weakened national economy, response by financial markets to last year's terrorist attacks and mild

(continued on page 6)

### PJM INTERCONNECTION, MIDWEST ISO, SPP PLAN TO OPEN JOINT TRANSMISSION MARKET BY END OF 2005

The PJM Interconnection, the Midwest Independent Transmission System Operator and the Southwest Power Pool expect to open their joint market by the end of 2005, officials with the three organizations told reporters Thursday.

PJM earlier this year agreed to form a common market with MISO, which later announced that it would merge with SPP. None of the three, however, had announced a date for commencing joint market activities.

At yesterday's new conference, Ken Laughlin, PJM's vice president of market services, said the partners must complete several actions before they can begin full market coordination. By June 2004, they will implement an "enhanced market portal," allowing parties in the three regions to enter bids and offers through a single interface. Bids and offers, however, would apply in only one of the three areas. By the end of





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the 2005, the entities hope to would create a common market, he added.

Laughlin said the common market would incorporate PJM's locational marginal pricing structure, with prices based on actual dispatch, updated on a five-minute basis. The parties also agreed that there would be financial transmission rights, day-ahead and real-time markets, and voluntary markets for bilateral transactions. Mike Gehagan, chief strategic officer for MISO, stressed that the pools must make sure that the PJM-MISO-SPP market design fits well with the "standard market design" (SMD) being developed by the Federal Energy Regulatory Commission.

Nick Brown, senior vice president at SPP, said some issues would be addressed on the local level, including transmission pricing, allocation of transmission rights, imbalance trading, market monitoring and metering. Other issues would be resolved jointly, including energy offers, price signals, financial transmission rights and construction of new transmission.

## CALIF. PASSES BILL GIVING STATE OVERSIGHT OVER PLANT OPERATION; DAVIS LIKELY TO SIGN

California Gov. Gray Davis will likely sign a bill the state Senate passed Thursday in a 23-13 vote that allows state agencies to more closely monitor the operation of power plants in the state, Davis staff said.

The bill, which the Assembly passed Monday in a vote of 45-26, gives the Public Utilities Commission and Independent System Operator authority to create and enforce maintenance procedures and to inspect closed plants.

The legislation was spurred by a slew of downed plants last year that exacerbated power blackouts and high wholesale prices. The state has taken no legal action finding generators purposely downed plants to increase prices, state lawmakers said a closer watch would deter any potential activity.

Generators said they expected the impact of the bill would depend on how tough the standards are when created by a committee of PUC and ISO appointees later this year. But any new standards will add to the risks of building new generation in the state, generators said.

## CALIFORNIA STILL VULNERABLE TO POWER, GAS PRICE SPIKES THIS SUMMER, ESAI SAYS

California's gas and power markets remain vulnerable to price spikes despite expansion of gas transmission and gas-fired power-generation capacity since 2000, Energy Security Analysis Inc. said in its latest North American *Natural Gas Stockwatch* released Thursday.

ESAI believes more in-state generating capacity, a return to near-normal hydro conditions, a decline in peak electricity demand and more flexibility on the intrastate and interstate gas transmission grids will lead to fewer shortages and less price volatility in the summer of 2002 compared with the summer of 2000 — provided it is not an extremely hot summer.

"However, since the expansion rate of interstate gas pipeline capacity since 2000 has not been rapid, the state remains vulnerable to insufficient capacity which could lead to gas price spikes," said Mary Menino, manager of natural gas markets at ESAI. In addition, "delays or cancellations of new generating or gas transmission capacity could be critical in the event of weather-related power demand surge," she said.

ESAI noted the state has added just over 2,000 MW of baseload generating capacity and 1,180 MW of peaking capacity — all gas-fired — since summer 2000, following a decade in which no new power generation was built in California.

Given that California's power-plant capacity appears to be growing more quickly than gas pipelines to feed it, "there is reason for concern that pipeline capacity might be tight this summer," ESAI noted.

## JUDGE TENTATIVELY BACKS KEY PART OF PG&E'S REORGANIZATION PROPOSAL

U.S. Bankruptcy Court Judge Dennis Montali on Thursday tentatively approved Pacific Gas and Electric's "disclosure statement" that will accompany its reorganization plan to be sent to the utility's creditors.

The statement is used to outline the utility's plan to creditors and its approval is a key hurdle the utility must overcome before it can send out its proposed reorganization plan for a creditor vote. Montali said final approval would likely occur at an April 24 hearing after the utility makes some minor changes to clean up the document.

At a hearing to discuss the few remaining objections to PG&E's statement, Montali cautioned there would be "no solicitation" of creditors until the mediation talks he ordered between the California Public Utilities Commission and the utility are concluded.

The PUC has had serious objections to PG&E's plan, primarily over the utility's effort to redesign itself by placing its transmission and generation under federal oversight. The PUC decided to create an alternate plan keeping the utility intact and under state oversight. Details of the PUC plan are expected to be filed to the court on Monday, said a PUC lawyer.

In addition to addressing PG&E's statement, the April 24 hearing will allow discussion on the status of the two plans since both would then be formally before the court. Montali also set a May 9 hearing to begin discussion of objections to the PUC's plan. Montali said last month that if he approves the plans' disclosure statements, they could go to creditors by mid-June.

## MD. REGULATORS APPROVE SETTLEMENT AGREEMENT FOR PEPCO/CONECTIV MERGER

The Maryland Public Service Commission Thursday endorsed Potomac Electric Power's merger with Conectiv, when it approved a settlement the utilities reached earlier with state intervenors that requires them to extend by 30 months current caps on retail electricity rates. Under the agreement, the companies will maintain the rate freeze through 2006 and provide $1-million for energy efficiency programs.

The combination has already received approval from Delaware and Virginia state regulators, the Federal Energy Regulatory Commission, and the Dept. of Justice. PEPCO and Conectiv are still awaiting rulings from utility regulators in New Jersey and the District of Columbia as well as the Securities and Exchange Commission. A Conectiv spokesman said the companies hope to complete the merger later this spring. Under the proposal, Washington, D.C.-based PEPCO would acquire Delaware-based Conectiv for $2.2-

billion, creating a company with 1.8 million customers.

PEPCO has divested most of its power plants to concentrate on delivery and unregulated services. While Conectiv has sold most of its baseload capacity, it has retained about 1,600 MW of "mid-merit" plants, which are fuel-flexible units that can be turned on and off quickly to respond to changes in the market. The utility is developing more mid-merit plants and plans to bring on-line another 3,300 MW in the next five years. Recently, part of Conectiv's baseload divestiture collapsed when NRG Energy cancelled a $170-million purchase of 794 MW in New Jersey and Pennsylvania, citing low power prices and high costs to upgrade the plants to meet new environmental requirements.

## SUPPLIERS LAUD FERC MARKET-DESIGN PAPER, STATES SAY LMP WILL NOT WORK EVERYWHERE

Wholesale suppliers applauded the Federal Energy Regulatory Commission's standard market-design working paper that proposes creation of a new transmission service aimed at promoting non-discriminatory access to the grid and would mandate locational marginal pricing to manage congestion throughout the country.

But state regulators and several utilities urged the commission to ensure that regional differences are accounted for and said they are not convinced that LMP, a congestion-management system based heavily on a model implemented by the PJM Interconnection, can work in all parts of the country.

FERC last month released a staff working paper that outlined initial directions FERC is likely to follow in developing a single market design (RM01-12). The effort is viewed as the third installment in a market-based trilogy that started with FERC's 1996 landmark Order 888 decision and 1999's regional transmission organization rulemaking Order 2000.

In this rulemaking, the commission is steering industry toward a single transmission tariff that would create a transmission service combining network transmission with point-to-point, giving suppliers more options when they look to move power across the grid.

Wholesale suppliers, including their trade organization the Electric Power Supply Assn., lauded the working paper and FERC's push toward a single tariff, claiming it "will promote comparability and eliminate undue discrimination."

"The new network service with full grid access will go a long way to putting in place the national, level playing field needed for...robust, competitive electric wholesale markets," EPSA said.

"Such standardization will bring benefits to end users and market participants alike by creating efficient, price-responsive, deep, and liquid energy markets regardless of the scope of transmission control areas, dramatically reducing seams issues," PJM and the Midwest Independent Transmission System Operator said in joint comments. "MISO/PJM agree...that this, in turn, will produce more efficient markets, provide more customer choices, improve services, widen trading opportunities, improve reliability, create greater investor confidence, and expedite infrastructure improvements."

State regulators and several utilities, however, cautioned FERC against moving quickly to a nationwide LMP system, saying that while it may work well in tight power pools, it could create havoc in other parts of the country.

"[T]he Pacific Northwest differs significantly from the capacity-constrained electricity grids in the East that are dominated by thermal generation," the Washington Utilities and Transportation Commission said. "The Pacific Northwest portion of the Western System Coordinating Council...has a winter capacity reserve margin of 29 percent. Hydroelectric facilities provide 71% of the plant capacity in this system. But, hydropower provides only 60% of the annual electricity generated. Clearly, the Pacific Northwest system is not constrained by lack of capacity; it is constrained by lack of energy—in this case, water to run through the hydroelectric turbines."

"Locational marginal price signals would ignore decades of the Northwest's resource and transmission planning and decisions," the Northwest Requirements Utilities and rural cooperative PNGC Power said. "This history of planning and decision-making has resulted in large hydro-generation projects located remotely from load in combination with base-loaded thermal units, which form an integrated and coordinated power and transmission system that does not lend itself to locational marginal pricing."

## NEW PLANT CONSTRUCTION TO BE 57,000 MW LESS THAN PROJECTED, ANALYST REPORT SAYS

A new report from Energy Venture Analysis released on Wednesday says the amount of new power plant generation that will actually be built is markedly less than planned, around 57,000 MW off prior estimates.

The analysts made their projections in a March 2002 report released Wednesday, called "Tracking the Boom of New Power Plants in the U.S."

A second report released the same day, "U.S. Reserve Margins, April 2002," said that, while the U.S. average reserve margin should be at or well-above the industry target of between 15% and 20% through 2010, some regions could fall below a 10% reserve margin.

"A few regions only recently attracted the interest of developer's—just before the current crunch in new power plant financing. Those regions have a high proportion of capacity that is vulnerable to cancellation or delays," said Michael Schaal, senior analyst for EVA.

As of the end of the first quarter of 2002, a total of 263,000 MW of new gas-fired capacity was under construction or in active development, EVA said.

On top of that number, around 11,000 MW of generation began operation during the quarter, the Arlington, Va.-based group said.

Over the 1998 to 2007 period in the power plant study, 348,000 MW of capacity will have started operation or been under development, representing a 6% decrease from the previous quarter. Further assessments indicate that cancellations and delays will increase as 2002 progresses, leaving only 291,000 MW of the industry-planned capacity to actually get built, the study said.

"The flurry of cancellations and delays have resulted in the net loss of 20,000 MW of capacity under active development during the first three months of the year," said Schaal.

The analysts blamed the recent pullbacks on a number of factors, notably the loss of easy access to capital in the financial markets. Ongoing uncertainty about the money situation is expected to continue, determining when and




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where new generation will be built, if at all.

And the North American Electric Reliability regions reserve margins that could be hardest hit (with reserve margins at less than 10%) by the pullback in generation should be the Virginias and the Carolinas (VACAR) in the Southeastern Electric Reliability Council, the Southwest Power Pool, and the Mid-Continent Area Power Pool, EVA said. Although, Schaal said that the VACAR region may not be as bad off as originally thought, mainly because demand growth has not increased as much as expected.

The regions that have a "robust" reserve margin (between 20% and 40%) include the East Central Area Reliability Council, Florida Regional Coordinating Council, Mid-Atlantic Area Council, Mid-America Interconnected Network, and the Northwest and Rocky Mountain areas within the Western System Coordinating Council.

EVA said that "overbuilt" regions (with reserves of more than 40%) include the Electric Reliability Council of Texas, the New England and New York regions, the Entergy and Southern regions in SERC, and the Arizona and New Mexico regions within the WSCC.

The company's reserve-margin study also said that the U.S.'s margin will likely peak in 2004 at 37%.

## MICROTURBINE SHIPMENTS RISE 15% IN 2001, FAR BELOW BEGINNING-OF-YEAR FORECASTS

While shipments of microturbines—high-speed electric generators of 30-300 kW—grew 15% in 2001 to approximately 1,400 units, the numbers were "far below" manufacturers and industry analysts' forecasts at the beginning of the year, according to a new study by Madison, Wisconsin-based Primen, an energy analysis firm.

These projections called for shipments to reach 3,500 to 5,500 units in 2001, a growth rate that would have matched the previous year's 400% increase.

"The optimistic forecasts were influenced by the enormous uncertainty in energy markets at the time," study director Nick Lenssen said. The highly visible energy problems of California in late 2000 and early 2001 called attention to power shortages in the state and it was "reasonable to assume that the crisis would continue through 2001 and...lead to a heightened interest in stand-alone power generation," Lenssen said. But the relatively sudden end to the state's crisis and a weakening U.S. economy led to reduced capital spending.

The study said that it was clear by the third quarter of 2001 that some units shipped by manufacturers to distributors weren't selling. In early August, Capstone Turbine, which accounts for roughly 90% of the market, warned that its third-quarter shipments would fall substantially below projections. A few weeks later, Honeywell Power Systems, then the number-two microturbine manufacturer, announced plans to halt operations and buy back all its units in the field.

The study said microturbine forecasts also failed to consider other barriers to market acceptance, including higher-than-projected natural gas prices, which made the technology uncompetitive with grid-supplied power, and technical problems that continued to trouble some developers and vendors.

What lies ahead for the microturbine industry? "Given the market realities, we see manufacturers retreating from expectations of mass-market applications in which microturbines competed head-to-head with the traditional power grid," Lenssen said. "Instead, manufacturers will need to work on developing advanced technologies that will fill market niches."

## PA. APPROVES MOVE OF 180,000 CUSTOMERS FROM NEWPOWER BACK TO PECO ENERGY

The Pennsylvania Public Utility Commission Thursday approved PECO Energy's request to complete NewPower Holdings' contract to serve about 180,000 customers at discounted rates through January 2004.

Purchase, N.Y.-based NewPower, which has been under growing financial pressures, in February said it would stop serving the customers, which it had won under contract in 2000. Under the order, Philadelphia-based PECO will charge the same discounted rates, with no changes in the terms or conditions they received from NewPower until the contract expires.

NewPower customers will be moved to PECO beginning April 25. The customers represent 13% of PECO's total number of residential customers. PECO's restructuring agreement requires it to have 50% of its residential and commercial customers served by alternative suppliers by January 2003.

NewPower has been serving the residential users since late 2000, after it won a PECO bid to provide "competitive default service" (CDS). In the CDS program—required by PECO's restructuring agreement—the utility bid out 20% of the small customers that were not buying power in the open market.

Despite the contract, NewPower lost $327-million last year, more than double its $157-million loss in 2000. In February, the company agreed to be acquired by London-based Centrica for $130-million. Centrica said it would send the PECO customers back to the utility because the contract was not economical, largely due to high capacity costs in PJM. But last month, the proposed acquisition collapsed because of complications related to Enron, which owns about 44% of NewPower. NewPower said it would go ahead with sending customers back to PECO.

PECO tried to find other retail suppliers for the 180,000 customers, but failed to reach any agreements after talking with several companies, a PECO spokesman said.

Under the order, PECO will supply power at 5.71 cents/kWh, or 2.02% lower than PECO's standard residential rate, and at 5.99 cents/kWh for residential heating customers, which is 1.02% lower than PECO's heating rate. PECO will notify the customers beginning April 18, and will resume service to them between April 25 and May 24.

In 2003, PECO is required to bid out 50% of its residential and commercial customers, and the company is talking with the PUC about that obligation, given the reluctance of marketers to take on this load, the spokesman said.

## MASS. UTILITIES SETTLE SUIT OVER USERS MISTAKENLY SWITCHED TO DEFAULT RATES

Boston law firm Grant & Roddy said Wednesday it has reached a settlement in principal with Massachusetts Electric and Western Massachusetts Electric in a class-action suit filed on behalf of customers who the utilities inadvertently switched from standard-offer service to more pricey default service.

Earlier this year, the law firm reached an agreement in a



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similar suit brought against NSTAR. The utility agreed to refund 23, 700 customers $1.45-million.

A Grant & Roddy spokesman declined to give out the cash settlements for Mass Electric and Western Mass Electric, or the number of customers involved, because the specifics have yet be filed in court.

The utilities buy standard-offer power under long-term contracts, and it has been typically the cheaper of the two services. Default service, set up for customers who are new to the service territory or who have lost their competitive supplier, is pegged to market rates, based on short-term supply contracts.

In the NSTAR case, many of the errors occurred when customers moved, but stayed within the same service territory. Customers did not notice the mistakes immediately because standard-offer service and default service were priced the same during the early years of deregulation. About a year ago, regulators changed the rules so that default-service prices would more closely reflect the market. Shortly after that default-service prices skyrocketed.

## FTC SHOULD EXEMPT ENERGY MARKETERS FROM PROPOSED 'DO-NOT-CALL' LIST: NEM

The National Energy Marketers Assn. is urging the Federal Trade Commission to exempt energy marketers from a national 'do-not-call' registry proposed as part of the FTC's changes to the Telemarketing Sales Rule.

NEM asserted that applying the proposed rule to energy marketers would hinder the competitive energy market, since it is one of the most cost-effective means of enrolling customers, and that telemarketing sales should be a matter of state and local jurisdiction. The National Assn. of Regulatory Utility Commissioners also will urge the FTC not to infringe on state activities restricting telemarketing operations, according to Brad Ramsay, NARUC general counsel.

The FTC early this year proposed to establish the national do-not-call list, making it illegal for telemarketers to call consumer who place their phone number on national registry. It is taking comments on the plan through April 15.

About 22 states already have do-not-call lists and 18 others are considering such steps, which should not be harmed by the FTC plan, Ramsay said.

NARUC in February adopted a resolution that supports the FTC strengthening consumer protections on telemarketing "so long as these protections, serve as a nationwide minimum standards which do not pre-empt state regulations which provide greater protection to consumers." The resolution supports the FTC establishing a national do-not-call list that incorporates existing state lists. 'We're all for more consumer protection, but not at the expense of existing protections," Ramsay said.

State regulators "have recognized the value of telephonic enrollment to foster the growth of the competitive energy market" and are aware of the consumer protection and slamming issues posed by telemarketing, NEM told the FTC. Calls by energy marketers serve the dual purpose of educating consumers about competition in addition to the sales component, NEM said.

Use of a national list "could impose significant burdens on the nascent competitive energy industry," the group said.

Other parties filing comments with the FTC supported the national list, arguing that companies can use other, less intrusive means to reach consumers, such as advertisements and by mail.

## NEPOOL EXTENDS CONTRACT FOR ISO NEW ENGLAND TO OPERATE REGION'S GRID

The New England Power Pool has decided to extend the contract of the New England Independent System Operator for up to 18-months after its original contract expires June 30, NEPOOL officials confirmed Wednesday.

Under a proposal the NEPOOL Participants Committee unanimously approved April 5, the ISO will continue operating the New England energy markets and transmission grid for another nine months from July 1, 2002 to March 31, 2003, the officials said.

NEPOOL can then extend the contract another nine months to Dec. 31, 2003 based on consultation with the membership, but without the need for a new vote.

The ISO was hired by NEPOOL in 1997 to operate the system under a five-year contract. In January, NEPOOL had issued a request for qualifications seeking a replacement for the ISO starting July 1. NEPOOL officials said that they had received some "expressions of interest" from outside entities but that the pool decided keeping the ISO was the best alternative.

They said NEPOOL chose the 18-month contract extension period to allow time for proposals to set up a Regional Transmission Organization in the Northeast and to advance and clarify what role the ISO will have over the longer term. NEPOOL will file the details of new contract to the Federal Energy Regulatory Commission for approval after a waiting period for appeals from the membership.

## ENTERGY SEES RECORD 'OPERATIONAL' EPS, BUT ACTUAL NET WILL PLUMMET

Entergy common stock hit a new 52-week high Thursday but ended up closing at its low for the day, after the company said it expects record first-quarter "operational earnings" but predicted a substantial drop in net income as it ends development of new greenfield power plants in the U.S. and Europe.

"Overbuilt power markets are expected to continue to reflect depressed power prices," Entergy said. "The company expects this decision to improve its already strong financial condition, substantially reduce capital expenditures that would have been made in already oversupplied markets, and enhance financial performance by redeploying capital into more financially attractive investments."

The stock hit the new high of $45.40 shortly after the New York Stock Exchange opened, but ended up down 9 cents (0.2%) at $44.50, the day's low. But that was up 15.2% in a year.

Entergy plans to report first-quarter results April 25, and expects "operational" earnings per share of at least 76 cents, up from the previous record of 75 cents in first-quarter 2001, and beating the consensus analysts' forecast of 69 cents.

Actual first-quarter 2001 basic EPS were 70 cents. Entergy reaffirmed the previous forecast for 2002 operational EPS of $3.40-$3.60.

Regulated U.S. utility earnings are expected to drop due

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to lower industrial sales, warmer weather, and higher operation and maintenance costs. Entergy Nuclear will benefit from the September 2001 purchase of the Indian Point-3 unit.

Energy Commodity Services will see better results from strong trading performance, and a full quarter's contribution, from the Entergy-Koch LP partnership, formed in early February 2001.

The charge against first-quarter 2002 EPS is seen at $1.15 to $1.35. The charge will reflect impairment of assets "consistent with Entergy's market point of view, disposition of certain commitments, and restructuring of Entergy Wholesale Operations (EWO)."

EWO would emerge from this restructuring as asset operator of about 2,500 MW, now operational or under construction. EWO also will pursue acquisitions of existing, or partially completed, plants "priced consistent with its market point of view, with a particular emphasis on assets providing trading value to Entergy-Koch LP."

The biggest share of the charge relates to Damhead Creek, an 800-MW plant in Kent, England, that entered service last year, and turbines contracts with GE Power Systems.

In the 2001 Form 10K, Entergy said low electricity prices led to the charge for Damhead Creek. Regarding the turbines, in October 1999 EWO obtained contracts to acquire 36 turbines from GE, and in May 2001 sold its rights and obligations under pacts for 22 of them to a third party, under an "off balance sheet financing arrangement."

EWO has placed 17 of the originally planned 36 turbines at sites that are either operating, under construction, or sold. Also, as allowed by the May 2001 deal, cancellation of four turbines is pending.

## FIRSTENERGY STOCK SLUMPS ON CUT TO EXPECTED 2002 EPS

FirstEnergy common stock slumped $1.23 (3.6%) to $32.76 Thursday, following its Wednesday announcement lowering 2002 earnings per share guidance to a range of $3.19-$3.34, including the effect of the Davis-Besse nuclear unit outage, which is expected to cut EPS 11 cents/share. The previous guidance was $3.45 to $3.65. FirstEnergy sees first quarter EPS at about 40 cents.

But Thursday's closing price was up from the day's low of $32.25, and up 17.5% in a year. The company's lower outlook stems mainly from lower power sales due to unseasonably mild weather, the continued economic slowdown, and accounting changes related to pension costs.

Also, FirstEnergy has reclassified Argentine utility holding company Empresa Distribuidora Electrica Regional, S.A. (Emdersa) as an "asset held for sale," which is going to eliminate reported income from that unit in 2002. GPU (acquired by FirstEnergy Nov 7, 2001) bought Emdersa in March 1999 for $375-million. It owns three distribution companies in northwest Argentina.

FirstEnergy has also begun a cost-reduction effort, reflected in the revised earnings guidance, in addition to anticipated acquisition-related savings. In first-quarter 2001, FirstEnergy EPS were 45 cents and GPU's were 58 cents

## INDIANA REGULATORS INK DEAL AGREEING TO AEP'S PLANNED CORPORATE SEPARATION

The Indiana Utility Regulatory Commission will not challenge American Electric Power's plan to restructure into separate regulated and unregulated companies under a settlement approved Wednesday that also extends through 2007 base-rate and fuel-rate freezes currently in effect for AEP's Indiana and Michigan Power subsidiary.

AEP filed its corporate separation plan last year with the Federal Energy Regulatory Commission, which is expected to issue a ruling later this year.

I&M Power, based in Fort Wayne, already had agreed to a rate freeze for its Indiana customers more than two years ago as part of the URC's review of AEP's then-pending acquisition of Central and South West. The existing freeze was to have expired in 2004.

However, the settlement provides for a new base-rate freeze during the period from Jan. 1, 2005, to Dec. 31, 2007, and a new fuel-rate freeze starting with the March 2004 billing month and continuing to the end of the December 2007.

During these periods, I&M Power may request an increase in its base rates and fuel rates only if the commission determines that a *force majeure* event has occurred.

An intervenor in the URC case, the I&M Industrial Group, is satisfied with the settlement approved by the commission, according to attorney Bette Dodd. "We view the extension of the fuel-clause freeze and the base-rate freeze as an insurance policy" that her clients will not be adversely affected by the corporate separation, she said.

## AEP-AQUISITIONS *(continued from page 1)*

weather, is prompting a number of companies to consider selling existing regulated and unregulated electric generating plants, possibly for prices below face value.

In AEP's newly released 2001 annual report, Draper said the company is counting on "continued strategic acquisitions and development of wholesale products and geographic regions" to help it meet its 6-8% 2002 growth target. Given current market conditions, "it's more challenging to make money" this year, Draper told analysts, "but we're on track to do it."

Draper also said he is confident the Securities and Exchange Commission "will write a stronger order" affirming its previous approval of AEP's June 2000 acquisition of Dallas-based utility Central and South West. Earlier this year, a federal appeals court sent the merger case back to the agency for additional review.

AEP owns 38,000 MW of generation, 18,000 MW of which is unregulated, in the U.S. and another 4,000 MW in the United Kingdom. It also owns 38,000 miles of transmission and 186,000 miles of electric distribution lines.

## SENATE-BILL *(continued from page 1)*

representatives from consumer groups, the energy industry and federal agencies related to energy. The 11-member commission would receive up to $400,000 from the Dept. of Energy to operate, and would have 180 days to complete its duties before being disbanded.

Feinstein and Sen. Charles Schumer (D-N.Y.) oppose a bill that would require refiners to blend five billion gallons of renewable fuels into gasoline by 2012, effectively mandat-

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ing the use of ethanol. Feinstein said the provision would cause fuel "prices to soar," as well as supply shortages and more pollution. Feinstein proposed delaying the start of a phase-in period for the standard by one year to 2005, and reducing the amount of renewable fuels required to be used. Schumer offered an amendment to strike the standard calling the mandate a "hidden gasoline tax."

Their stand pits them against Majority Leader Thomas Daschle (D-S.D.) and other farm-state senators. Daschle told reporters he thinks he has enough support defeat the amendments. At press time, the Senate was voting on the Schumer amendment.

The Senate is expected to finish its work on the energy bill next week.

## NYSEG-NUCOR *(continued from page 1)*

economic benefit.

In its April 5 rehearing request, NYSEG said the order was approved by only one PSC member and asked that the commission conduct formal hearings on the discounted rate, arguing that Nucor submitted its proposed contract terms under "trade secret" provisions.

The utility said the seven-year contract approved by the commission would save Nucor nearly $54-million, a cost that its remaining customers would have to bear. The $54-million figure, a NYSEG spokesman said, is roughly equal to the amount by which the utility promised to reduce rates after it sold its 208-MW stake in the Nine Mile Point nuclear station to Constellation Nuclear.

"From the commencement of this proceeding, Nucor has had one goal in mind—to use every available lever, including political manipulation, obstruction in other proceedings, regulatory secrecy, and journalistic misinformation, to extort enormous and unprecedented rate concessions from NYSEG and its customers," the utility told the PSC. It also criticized "the enormous magnitude of ratepayer funds being provided to a single customer," and noted that the common stock of Nucor is currently trading at its highest level in more than five years. Further, NYSEG pointed out that Nucor plants successfully operate in other states, at rates higher than NYSEG's standard tariff, which "raises questions as to the need for any rate relief."

Nucor officials would not comment on the utility's filing.

## SENATE-FERC *(continued from page 1)*

Loretta Lynch, president of the California Public Utilities Commission and state Sen. Joseph Dunn, chairman of the California Senate Committee investigating wholesale price manipulation, told Dorgan's panel that they have not seen any evidence of a FERC investigation in California. "We have seen zero from FERC and its investigation in California," said Dunn.

Dunn and David Freeman, chairman of the California Power Authority, admitted that the state's deregulation plan—largely derided as ill-conceived—perhaps teed up the market for price spikes, but it was FERC's job to police the market and protect consumers.

"The California Legislature may have left the car unlocked. But Enron stole that car and FERC, the cop on the beat, did nothing about it," said Dunn.

FERC declined to comment on its investigation in the Western power markets. "It is an ongoing investigation, and, as such, we never discuss an investigation that is going on," a commission spokeswoman said. FERC Chairman Pat Wood has asked staff to conclude its probe "as soon as practicable," she said.

Late last month in compliance with a March 15 subpoena, Enron gave FERC
"two large data bases" and "one boxful" of documents and CD-ROMs involving EnronOnline, Enron Power Marketing and units, said Sam Behrends, a Washington attorney representing Enron 1.




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**February 22, 2002**

## AES Corp. Continues to Struggle, Despite Efforts to Restructure and Reduce Debt

**By Will McNamara**
**Director, Electric Industry Analysis**

[*News item from The Wall Street Journal*] Moody's Investors Service put the long-term debt of Arlington, Va.-based AES Corp. (NYSE: AES) on review for possible downgrade, citing concerns about the energy company's liquidity as its shares slid 11 percent on Feb. 20 to a new 52-week low. Meanwhile, Standard & Poor's Ratings Group, which last week had put AES debt on CreditWatch with negative implications, said, "The market's response to recent events has been somewhat overblown." Nevertheless, AES shares fell 50 cents to $4.25 in composite trading on the New York Stock Exchange as investors scrambled to assess a restructuring plan unveiled by the company this week. AES shares are off 93 percent since a 52-week high of $60.15 on Feb. 21, 2001, and are presently priced at $3.55.

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**Analysis:** There is an immediate pressure bearing down on AES to raise cash and reduce capital spending without hurting cash flow. As such, in what may appear to some as a desperate measure to regain investor confidence in its business model, AES has unveiled a two-level restructuring plan. The company plans to sell both domestic and international assets (including physical generating plants, a utility holding company in Illinois and a retail operation) with the hope of gaining between $1 billion and $1.5 billion in cash. In addition, AES plans to significantly scale back its expansion efforts by canceling a good number of planned power projects. Theoretically, the goal of both restructuring efforts, in addition to hopefully bringing AES much-needed cash resources, will be to make the company less reliant on capital funding over the next year. The inherent problem with this strategy is one of poor timing. Apart from other factors, AES has announced its plans to sell physical assets at a time when numerous other energy companies are also selling generating plants (often at fire-sale prices), which has created something of a saturated market that is good for buyers but not necessarily good for sellers. Just like AES, other companies are presently attempting to divest assets that are expendable to strengthen balance sheets and reduce debt. What this could mean for AES is that, even if it is able to find a buyer for its physical assets, some of which are considered high risk and tailored to AES' unique business model, the company may not be able to earn cash proceeds in the range of $1.5 billion on which it is counting. The bottom line is that the current prognosis is not very good for AES, a company that blazed its own unorthodox strategy and is now suffering some rather harsh consequences. In addition, as illustrated by AES' current stock price, investors are not responding well to what may be an unrealistic restructuring plan, which could be an indication that the company's problems won't be resolved any time soon.

I have been tracking AES' fall in this column for the last several months, so I won't waste space here on the factors that brought about the company's current plight. For background information, please see my **Issue*Alert*** from 2/7/02 and 10/17/01, available at www.scientech.com/rci. In this column, I will focus exclusively on the company's current restructuring efforts and the downward spiral from which AES may be hard pressed to extricate itself. From a financial perspective, at this time AES says that its total liquidity is about $265 million, including a $150-million revolver loan credit. This is an important point as the company now says it hopes to rely exclusively on internally generated cash flow. Yet, to avoid obtaining fresh money from capital markets this year, AES acknowledges that it will have to obtain new cash resources by divesting some of its assets.

As such, AES believes it can raise up to $1.5 billion by selling assets, including businesses located in Latin America, merchant facilities in New York and California, a coal-fired facility in the Dominican Republic known as Itabo, and some of the businesses that the company obtained in its March 2001 acquisition of IPALCO Enterprises. In addition, AES plans to cut capital spending for 2002 by $490 million to $710 million, down from a previously planned $1.2 billion mainly from projects in construction. AES says that with the spending cuts alone (in other words, excluding any asset sales), the company will have $374 million in cash and credit at the end of 2002. Note that, contrary to some reports, AES announced on Feb. 20 that it will not divest its 3,870-MW Drax power station in the United Kingdom or abandon major European construction projects already started on the Continent (such as a 1,200-MW gas-fired station planned for Cartegena, Spain). Reading between the lines, although under pressure, AES is first selling those assets that it has deemed non-essential or exceedingly high risk (such as retail and U.S. merchant businesses and operations in Latin America) and keeping those that are viewed as strategic (European generating facilities). What will be left as AES' core business, at least in the United States and at least while the company restructures, apparently will be contract generation, or the building and running of power plants for third parties, which represents a far-less aggressive strategy for the company than had been pursued in the past few years.

Looking specifically at some of the assets that AES will most likely sell, the company has said it will divest a minority stake in IPALCO Enterprises, an Indiana utility. AES completed its purchase of the company in March 2000, at which point IPALCO became a wholly owned subsidiary of AES. At the time of the acquisition, the Indianapolis, Ind.-based utility had 3,000 MW of generation and 433,000 customers in and around Indianapolis. IPALCO was also parent to CILCORP, a utility holding company in Illinois whose largest subsidiary CILCO is an energy service company that serves portions of Illinois and Missouri. In addition to the minority stake in IPALCO, it is the ownership in the CILCORP asset that AES has now begun the process to sell. Note that pursuant to a Securities and Exchange Commission order at the time of the acquisition, AES agreed to restructure and/or sell its ownership interests in CILCORP within two years in order to retain its status as an exempt holding company under PUHCA. Thus, AES' decision to sell its minority stake in IPALCO Enterprises / CILCORP should not be seen solely as a response the company's current financial problems.

AES also owns and operates a number of power projects in Latin America, which reportedly accounted for 51 percent of the company's pretax earnings last year, and will likely begin a process to sell interests in Colombia, Argentina and Venezuela. Highlights include acquiring a controlling interest in Electricidad de Caracas, the largest private electricity company in Venezuela, which reportedly had been forecast to contribute 10 percent to AES' cash flow in 2002 (as it had done in 2001). However, in the fourth quarter of 2001, profit at AES fell about 80 percent due to losses from its Latin American operations and the devaluation of currencies in those regions. Due to the fact that companies such as Argentina and Venezuela, which are inherently prone to political turmoil, have recently suffered currency devaluations, some analysts have concluded that AES' assets in Latin America will be particularly hard to sell. For instance, AES' Venezuelan unit has been hit hard by President Hugo Chavez's decision to allow the Bolivar currency to trade freely. Since the president's decision, the Bolivar has fallen by more than 10 percent. The volatility of the Latin American markets has already been a factor for AES, which has been impacted by investor concerns about the company's exposure in this region, so it is questionable whether or not another company would willingly take on the same risks at this time.

Moreover, the heat has been turned up on AES and what occurs over the next few weeks could be a strong indication of where the company heads from this point. We know that the credit downgrades have made it unlikely that lenders will be willing to make loans to AES, so the company has now been forced to become self-reliant from a cash-resources perspective. So, AES clearly will be challenged to build its redefined strategy of focusing primarily on contract generation, which as noted is the business of building and running of power plants for third parties. In the long run, this may be a prudent move on AES' part, as the company says this focus will protect it by having businesses in which earnings are largely isolated from commodity price risk. In addition, this is a business that AES already has developed as its core business, although it made the apparently unsuccessful move into diversification several years ago. In other words, AES is now focusing exclusively on what was always its core business. As of today, current data indicate that AES has 63 contract businesses in operation, construction or development in 32 countries, and its 48 operating businesses reportedly total 20,863 MW. The company has nine businesses under construction totaling 4,800 MW and six businesses in advanced development totaling more than 2,660 MW. As a whole, contract generation accounts for 40 percent of AES' total generating portfolio.

However, although AES may have concluded that its contract generation strategy is less prone to risk than its diversification approach into businesses such as telecom and regions such as Latin America, the company's core business has hit some bumps along the way. For instance, under its contract generation business, AES established several tolling agreements with Williams Corp. for the power plants that AES owns in California. Under the tolling agreements, AES essentially rents its plants to Williams so that Williams can generate fuel to electricity, which it then can sell on the wholesale market. In other words, Williams had a contract to market all of the power generated by AES' California plants. In hindsight, AES may regret the questionable decision to enter into the tolling agreements with Williams in California. Although AES did well in the booming California market where price spikes became the norm in 2000 and into 2001, the company reportedly lost $11 million on the lucrative California market. Meanwhile, Williams reported 2000 income from continuing operations of $873.2 million, or $1.95 per share on a diluted basis, versus $178 million, or 40 cents per share on a restated basis, for 1999. AES also took a hit when it had to pay air pollution fines and buy power on the wholesale market to meet its obligations to Williams when it was forced to shut some plants down. Thus, AES' retreat back to contract generation comes with its own set of risks that may continue to limit the company's earnings potential.

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# Electric Power Daily



## Markets

### AS OTHERS SUFFER, ONEOK LOOKS TO EXPAND TRADING OPERATIONS

Tulsa, Okla.-based ONEOK Tuesday said its asset-based energy marketing and trading unit is prospering amid market conditions that have devastated others, and is considering hiring traders that have been laid off by other firms.

"We have not experienced any decrease in our business at all. Our volume went up 7%," Chris Skoog, head of energy marketing and trading, told analysts during a conference call yesterday. ONEOK is a major gas production transportation and distribution firm with growing gas and power trading operations. The company is 45% owned by troubled Westar Energy of Topeka, Kan., which wants to sell back its ONEOK stake to raise cash and pay down debt.

Skoog said generators that once divvied up business now are turning to ONEOK as a one-stop gas supplier. "They are coming to us and saying, 'Would you like to double or triple your volume with us?' From that point of view it has been very good for us," he added. "We are going to grow this business, but we are going to grow it smartly and within the cash flow this corporation

(continued on page 6)

## California

### FERC JUDGE SCHEDULES MORE TALKS TO SETTLE CALIFORNIA CONTRACTS

The Federal Energy Regulatory Commission senior administrative law judge Tuesday scheduled an additional round of confidential settlement talks aimed at renegotiating long-term power contracts California signed last year with a number of suppliers.

FERC in April set the issue for hearing, but ordered the parties to try to settle on their own before convening a formal litigation process at the commission.

Chief ALJ Curtis Wagner Monday he would decide by Tuesday whether to move to a formal hearing or continue his efforts to broker as many settlements as possible.

But after more than eight hours of intense negotiations, Wagner late yesterday said the talks progressed further than he had expected, prompting his decision to hold three more days of settlement discussions at the end of the month. The talks will be held at FERC between

(continued on page 6)

### WILLIAMS WARNS OF 330 POSSIBLE TRADING LAYOFFS IN 60 DAYS, STILL HOPES FOR PARTNER OR BUYER

Williams Tuesday notified 330 energy marketing and trading employees at its Tulsa, Okla., headquarters that, while the company is still hoping to find a buyer or partner for its troubled EM&T operations, they face the prospect of being laid off this fall.

The employees were told to expect so-called "Worker Adjustment and Retraining Notification" (WARN) letters Thursday, an action that will allow the company to eliminate their jobs after 60 days.

Employees in Williams' Houston and London EM&T offices will receive less formal advisories informing them that their future with the company is in jeopardy

WARN letters are required under U.S. law when an expected staff reduction represents 50 or more full-time employees and would involve more than 33% of the workforce at a single employment sight within a

(continued on page 7)

### AQUILA COMPLETELY EXITS THE ENERGY TRADING BUSINESS AFTER FAILING TO FIND A PARTNER

Just six weeks after greatly reducing its role in the energy trading field it once helped rule, Kansas City, Mo.-based Aquila formally closed the coffin on that part of its business Tuesday.

Unable to find a partner, the company—which once ranked among the country's top five energy marketers—announced that it was exiting the field entirely. Energy marketing and trading will vanish, and the company's only off-system sales will come through its Capacity Services unit, which manages the power from generating facilities the company owns or controls.

In rapid succession, UtiliCorp United became Aquila to reflect the dominance of energy marketing in its overall business strategy, and then it announced plans to focus more on asset-based marketing as credit worries grew.

(continued on page 7)

### REPOWERING AGING PLANTS ON LONG ISLAND COULD MORE THAN DOUBLE CAPACITY, STUDY SAYS

Repowering steam plants to combined-cycle operation could more than double the generating capacity available to Long Island, N.Y., according to a study released Tuesday by Long Island University's Center for Management Analysis.

The report comes just days after the Long Island Power Authority (LIPA), the state owned utility, hit a record peak of 5,059 MW, which was covered by only 5,500 MW of supply.

Most of the plants on Long Island, roughly 4,000 MW, are owned by KeySpan, which acquired them when LIPA took over the distribution territory of Long Island Lighting (LILCO), and the rest of LILCO merged into KeySpan. These older steam units operate at efficiencies of only 35%, the study said, adding that the number could be doubled with combined-cycle operation. In addition, some simple-cycle turbines could also be expanded into combined-cycle operation.

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The first conversion could be completed by 2006, CMA estimated. The report added that while the repowering process requires taking plants off-line for 12-18 months, the first of some 1,100 MW of new merchant capacity is expected to begin coming on line in 2004 and could make up for any shortfalls while the plants are being retooled.

Repower is an economically attractive option because many elements are already in place, including the site, cooling systems, generators and electric and gas transmission, the report noted. Given that, repowerings can be completed at a cost of $700-$900/kW, compared with $1,100/kW for a new plant, CMA estimated. Repowering old plants also leads to a reduction in air emissions, despite the capacity increases, CMA added. Altogether, repowering existing steam plants and expanding some combustion turbines could add 4,700 MW to the island CMA said.

A LIPA spokesman said the report "states the obvious," and noted that LIPA and KeySpan are already studying the option. Though they believe repower is a viable option, the long outage times associated with the work are problematic. Supplies are already tight, barely covering demand, the spokesman said, and the first of the new merchant plants is not due on-line until 2004. "We can't afford to take baseload plant off-line until we get more supplies," he said.

## UBS ENERGY SAYS BUSINESS PLAN FOR 2003 WILL TAKE SHRINKING MARKET INTO ACCOUNT

Amid market rumors Tuesday about pending cutbacks in UBS Energy's trading operations, a company spokesman acknowledged that the firm is now making plans for next year, and that those plans will take into account the substantial shrinking of the power and gas trading markets that has occurred over the past six months.

UBS, which traditionally does not confirm nor deny rumors, told Platts yesterday that it continues "to see opportunities in the energy marketplace, and we are excited about the prospects of our business. The company has begun planning for 2003. There have been changes in the industry since we entered in February. The business process will takes these changes into consideration."

Several market sources said UBS was considering layoffs in its 650-employee Houston operation that it took over from Enron on Feb 15. The rumors ran in tandem with suggestions that Williams was also near to making a sizable reduction on its trading floor. Williams yesterday notified 330 energy marketing and trading employees at its Tulsa, Okla., headquarters that while the company is still searching for a buyer or partner for its troubled Energy Marketing & Trading unit, they face the prospect of being laid off this fall.

## PG&E NATIONAL ENERGY GROUP MOVES AHEAD WITH 160-MW KY. HYDRO PROJECT

Despite a trend in recent months of power project cancellations and delays largely in response to poor market conditions, PG&E National Energy Group is moving forward with construction of two merchant hydro plants with about 80-MW each at the Smithland and Cannelton dams on the Ohio River in Kentucky.

A PG&E spokeswoman said Tuesday the Bethesda, Md.-based company has executed construction contracts for both projects and has begun work on an initial 16-MW turbine at Smithland.

Construction recently was suspended by the company, however, to address U.S. Army Corps of Engineers concerns over seismic issues. The Smithland facility, in far western Kentucky, will be located within the New Madrid Fault zone, a region including parts of Missouri, Arkansas, Tennessee, Illinois and Kentucky prone to occasional earthquakes.

According to the spokeswoman, PG&E believes it has satisfied the Corps' questions about the project "and it won't require design changes." PG&E is awaiting the Corps' concurrence before resuming construction.

PG&E purchased the hydro projects late last year. At the time, Smithland was a limited partnership with one general partner, AJS Hydro, and one limited partner, DJL, both Kentucky companies. Cannelton was a limited partnership with one general partner, WV Hydro, and one limited partner, Clover Development, both Tennessee companies.

## MINN. DEVELOPER CANCELS 225-MW COGEN PLANT, BLAMING IN PART LOW POWER COSTS

Rapids Power, citing the slumping power market and high technology costs, Tuesday said it has canceled plans to build a 225-MW cogeneration plant in Grand Rapids, Minn.

The company is a joint venture of Minnesota Power and Blandin Paper, a subsidiary of UPM-Kymmene, a Finnish company.

The $200-million Rapids Power project was announced in August 2001 and was scheduled to come on-line in 2005. The proposed facility would have provided all steam requirements for the Blandin mill in Grand Rapids and additional generating capacity for the region.

"The Rapids Power technology remains the right choice for electric and steam requirements, but its cost is presently simply too high to support marketable electricity and lower mill steam costs," said Eric Norberg, vice president of strategic initiatives for Minnesota Power.

Separately, Minnesota Power said it is moving forward with plans to build a 170-MW natural gas-fired peaking merchant power plant near Superior, Wis. The Wisconsin Public Service Commission plans to hold a hearing on the project Sept. 4. Construction on the $80-million project is scheduled to be completed late next year. The site is being prepared to allow for the potential expansion to about 315 MW.

Rainy River Energy, a subsidiary of Minnesota Power, will own the power plant.

## AVISTA TO DELAY START UP OF 280-MW PLANT IN OREGON UNTIL LATE THIS YEAR

Avista Tuesday said it will delay until late this year start up of the 280-MW Coyote Spring 2, natural gas-fired plant in western Oregon.

The $330-million plant, which Avista owns with Atlanta-based Mirant, had been expected to begin operation next month, but a transformer fire at the site in May set back the facility's construction schedule.

Spokane, Wash.-based Avista said it is buying power to meet loads until the unit goes into operation and expects any financial impact will be minimal.

## NRG ASKS FERC TO CLARIFY WHEN IT MUST NOTIFY FIRSTENERGY OF PLANT CHANGES

NRG Energy is asking the Federal Energy Regulatory Commission to be more specific about its obligation to notify FirstEnergy should it make operational changes at four Ohio coal-fired power plants it is negotiating to buy from the utility for $1.5-billion.

Two FERC orders in July authorizing the acquisition left the Xcel Energy subsidiary unclear about its notification requirements, the company told the commission in a filing last week.

"The orders do not tell NRG Companies the amount of advance notice NRG Companies must provide to FirstEnergy, and do not specify what operational changes would trigger such a notice requirement," NRG said in a rehearing request.

NRG is concerned it might be exposed to "unknown liability if notice is deemed inadequate."

NRG said it received a copy of a July 18 letter agreement signed between FirstEnergy and the city of Cleveland that says both parties would be satisfied if NRG notifies American Transmission Systems, a FirstEnergy transmission subsidiary, when and if it plans to remove any of the four plants from service.

FirstEnergy, however, "never submitted this letter agreement for filing with [FERC] as a rate schedule, an offer of settlement, or as part of a request for rehearing or clarification," NRG said.

A NRG spokesman said the company's request for rehearing speaks for itself and had no further comment. "We're in serious negotiations [with FirstEnergy] and the negotiations continue," he added. FirstEnergy, the Akron-based parent company of Ohio Edison, Cleveland Electric Illuminating and Toledo Edison, said it has no position on NRG's latest filing and remains focused on completing negotiations.

## SCE&G FILES TO RENEW LICENSE FOR 900-MW SUMMER NUCLEAR PLANT IN SOUTH CAROLINA

South Carolina Electric & Gas said Tuesday it has filed a formal application with the Nuclear Regulatory Commission to extend its license to operate the V.C. Summer nuclear plant in Parr, S.C., for another 20 years.

The SCANA subsidiary holds a 66.7% ownership interest in the 20-year-old, 900-MW plant and it operates the facility. Santee Cooper, South Carolina's state-owned utility, owns the remaining 33.3%.

SCE&G said its original 40-year NRC license to operate the plant expires in August 2022. The facility is considered to be among the most reliable in the U.S., with an annual capacity factor among the highest in the Southeast.

## SOUTH CAROLINA ELECTRIC & GAS SEEKS 7% RATE RISE TO PAY FOR PLANTS, EMISSIONS

South Carolina Electric & Gas said Tuesday it has asked the South Carolina Public Service Commission to approve a roughly 7% increase in its retail electric base rates to become effective on Feb. 1, 2003.

Columbia, S.C.-based SCE&G, the primary subsidiary of SCANA, said the rate increase is needed to enable the utility to recoup the cost of two large power projects and various emissions-reduction projects undertaken over the past seven years.

SCE&G's last base-rate increase was implemented in stages in 1996 and 1997. The utility said the newly proposed rate hike is based upon a 9.93% overall return on rate base, including a 12.5% return on common equity, and would produce about $105-million in additional annual revenues.

If approved, the rate increase would enable SCE&G to recoup $248-million it has invested in repowering plants with gas and expanding its Urquhart coal plant; $277-million it is investing in a new 875-MW, gas-fired plant in Jasper County; and $222-million it has spent on emissions-related projects since 1995

With the increase, an SCE&G residential customer using 1,000 kWh/month would see a monthly bill rise to $88.57, from the $82.59 currently paid.

SCE&G provides electric service to about 550,000 customers and natural gas service to about 270,000 customers.

## REPORT RECOMMENDS REGULATORS, UTILITIES TREAD LIGHTLY IN THE TELECOM BUSINESS

Utility affiliate regulations and a changing business climate have limited the potential for utilities to take advantage of offering telecommunication services to consumers, but there still may be some opportunities, a consultant concluded in a new report.

As several telecom companies struggle to survive, many utilities are looking to increase their involvement in the field, and "in today's uncertain economic times, utilities are among the few players that have the financial resources to capitalize on the anticipated growth that is expected within the telecom sector," according to a white paper by Shpigler Group released Tuesday.

But failed efforts include the bankrupt telecommunications company Telergy's plan to use utility partners to build a fiber network, Conectiv's failed effort to offer local telecom services and Enron's bandwidth trading. Successful utility telecom ventures are those that have "stuck close to their knitting," the report said. "In other words, those utilities that created businesses that sought the greatest operational links to the inherent advantages their utility operations offered tended to do well," the report said. It cited FPL Energy subsidiary FPL FiberNet, wireless operations of Southern Company and cable offerings from Vectren Advanced Communications as some of the more successful ventures.

If a utility has built a fiber network to support internal communications, it's likely that excess capacity exists on the network that could be transferred to a subsidiary, the consultants said. Some states, however, require that such transfers or sales take place at prices above book value or that the assets be made available to others through a bidding process. Utilities eyeing telecom ventures should study the regulations that apply in their markets and craft their plans accordingly, including developing contingency plans should regulations change, the report said.

The consultant also offered advice to regulators:




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"Overly strict regulatory controls will not help consumers if they ultimately drive utilities out of the telecom business. Fair but reasonable controls should be enforced so as to invite utilities to enter this field—and offer consumers and enterprises greater telecommunications choices in the long run."

More information on the report, "The Impact of Affiliate Transactions on Utility Telecommunications Ventures," is available from the Shpigler Group at (845) 348-3181, or www.shpigler.com.

## EDISON POSTS $665-MILLION IN Q2 EARNINGS, SOCAL ED TO RECOVER DEBT BY END OF 2003

Edison International Tuesday posted second quarter 2002 earnings of $665-million, or $2.04 per share, compared with a loss of $102-million, or 31 cents per share, for the second quarter of last year.

It also reported $2.93-billion revenue for Q2 up from $2.45-billion a year-ago. The Rosemead, Calif.-based company estimated that its consolidated 2002 earnings will range between $1.65-$1.75 per share.

During a conference call, utility officials said Edison's utility arm Southern California Edison has paid off more than half the debt it incurred buying high-priced wholesale power in 2000 and 2001. Edison International Chief Financial Officer Ted Craver said the utility to date has recovered $2-billion through an account created by the California Public Utilities Commission under a debt-recovery settlement it signed with the utility last year. It expects to recover the remaining $1.6-billion by the end of next year, he added.

Company CEO John Bryson told analysts the utility still has a number of issues to resolve before it can return to creditworthiness, including a federal appeal of the settlement filed last year by The Utility Reform Network and a pending PUC ruling outlining how the utility will resume the role of power buyer. He said the company recently met with Moody's Investors Service and Standard & Poor's to discuss what would be needed to restore the utility's investment grade. S&P is a McGraw-Hill Companies unit.

"The general view is that SoCal Ed is improving," Bryson said. "We are still not back to the authorized equity level for SoCal Ed and there are continuing concerns" about the utility's ability to resume wholesale power purchasing obligations. "We need a little bit of time and to continue to show [the debt recovery account] is working." In addition to SoCal Ed, Edison International and its subsidiary Edison Capital have lost their investment-grade ratings. Power producer Edison Mission Energy has been the only Edison International subsidiary spared a downgrade.

SoCal Ed Chief Financial Officer Jim Scilacci said he expects the utility will regain creditworthiness by year-end, aided in part by a bill passed by the state Legislature last month. The measure (AB 57), which has yet to be signed by Gov. Gray Davis, would allow the PUC to approve in advance a utility's purchased power costs, eliminating the possibility that a utility will incur electricity costs that it could later be barred from recovering through retail rates. SoCal Ed incurred more than $3-billion in debt after it could not recover its power costs in rates.

The utility's improving financial health was bolstered by its Q2 earnings of $215-million compared with $91-million a year-ago. Edison said the $124-million increase for SoCal Ed primarily reflected increased revenues from the implementation of the PUC's April 2002 decision in the utility's performance-based ratemaking proceeding setting distribution revenues.

Other Edison units, however, did not fare well in the second quarter. EME reported less than $1-million in earnings from continuing operations in the quarter, compared to earnings of $41-million a year-ago. Edison said the decrease in EME earnings was due to lower U.S. energy prices in the second quarter, unplanned outages at the Homer City plant in Pennsylvania and gains during Q2 2001 related to gas swaps from EME's oil and gas activities.

During the call, Craver said that EME's liquidity position at the end of the second quarter was $713-million, with $681-million in unused credit lines and the remaining amount in cash. He compared the numbers to a year-ago when EME's liquidity was $263-million with only $16-million in unused credit lines and the remaining amount in cash.

Edison Capital's earnings for the second quarter were also lower, cut in half to $12-million from a year-ago. The decrease was attributed primarily to a new accounting method and no significant asset sales in 2002.

Edison International common stock jumped $1.03 (9.6%) to close at $11.78. But that was down 8% in a week and 14.3% in a year.

## AVISTA Q2 NET INCOME SLUMPS 45.4%; ENTERGY NET INCREASES 1.1% TO $241.6M

Avista Tuesday reported second-quarter net income of $12.1-million, down 45.4% from a year before, on operating revenue of $751.4-million, down 51.4%. Earnings per share fell to 25 cents from 47 cents, on average basic shares of 47,774,000, up 0.8%.

Net from Energy Trading and Marketing slid 64% to $8.5-million, as revenue dropped 54.5% to $574.3-million, even though power volume rose 25.4% to 12,370 GWh and natural gas 39.7% to 72,748 million Dt.

Avista Utilities net improved 18.5% to $12-million, on revenue of $191-million, down 39.8%. Retail power revenue was up 16.2% to $106.1-million, on volume of 1,728 GWh, down 4.5%.

Wholesale volume sagged 52.5% to 870 GWh, and with the average sales price plummeting 75.9% to $21.58/MWh, revenue fell 88.6% to $18.8-million. Gas revenue dipped 0.5% to $54.6-million as volume dropped 13.7%.

The net loss on Information and Technology Operations narrowed 24.6% to $4.3-million, as revenue increased 28.3% to $4-million. Other Operations lost $4.5-million, up 123.2%, on revenue of $3.4-million, down 2.3%.

Company-wide operating expenses fell 52.4% to $708.9-million, led by a 55.9% slide in "resource costs," to $611.3-million. Income taxes were down 41.5% to $9.7-million.

Avista maintained its predicted 2002 guidance for EPS of 70 cents to 80 cents, and now expects 2003 EPS to exceed $1.10.

**In other second-quarter results:**

**IDACORP** net slumped 91.7% to $3-million, on operat-

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ing revenue of $621-million, down 60.6%. EPS fell from 96 cents to 8 cents, on average shares of 37,665,000, up 0.7%.

The drop stemmed from the 32-cent loss at energy marketing and trading unit IDACORP Energy, versus year-before earnings of 83 cents—bringing the first-half loss to 21 cents, down from earnings of $1.44 in the first half of 2001. On June 21, IDACORP said Energy would begin winding down power marketing operations "in response to uncertainty in the political and regulatory environment, as well as a lack of creditworthy counterparties."

Second-quarter results include a $1-million restructuring charge on the wind-down. Energy's commodities and services revenue sagged 69.7% to $408-million, but cost of goods sold fell only 67.1% to $423-million.

Volume of settled power transactions surged 96.3% to 13,523 GWh, but gas slumped 62.6% to 11,707 mMBtu.

EPS from utility Idaho Power jumped from 16 cents to 33 cents, on revenue of $209-million, down 8.3%. Expenses were down 11.5% to $177-million, led by an 81.7% plunge in purchased power, to $31-million. However, expenses under the "power cost adjustment" were $42-million, versus year-before credits of $68-million.

Power general business revenue improved 20.5% to $187.5-million, on sales of 3,181 GWh, down 1%, led by a 20.8% drop in industrial, to 790 GWh. Residential rose 6.4%, commercial 3.4% and irrigation 16.7%.

But off-system sales fell 19.4% to 431 GWh, and with the average sales price down 76.8% to $25.46/MWh, revenue plummeted 81.3% to $11-million.

Company-wide interest on long-term debt was down 20% to $12-million. Income tax benefits were $9-million, versus year-before costs of $22-million, "reflecting the impact of the estimated annual effective tax rate being reduced to zero. The change in the rate is primarily the result of the reduction of forecasted pre-tax income to a level such that tax credits are now expected to fully offset income tax expense for 2002," IDACORP said.

**NiSource** net was $25-million, versus a year-before net loss of $11.6-million, on gross revenue of $1.37-billion, down 26.5%. EPS were 12 cents, versus a 6-cent loss, on basic shares of 205.6 million, up 0.1%, and diluted of 208.2 million, up 1.4%.

A year before, net was cut $9.2-million by impairment charges on fiber optic network operations. This year, net was boosted $7.5-million by the after-tax gain on the April 30 sale of the assets of Indianapolis Water and other assets of IWC Resources and subsidiaries to the City of Indianapolis for $540-million. That day, NiSource also sold its interest in White River Environmental Partnership (an IWC investment), to the other partners for $8-million, about book value. The after-tax operating loss on these discontinued operations jumped 88.2% to $3.2-million.

In the second quarter Merchant Operations' operating loss was $25.8-million, versus year-before income of $17.9-million. Gas net revenue was down 59.5% to $173.6-million, as volume dropped 39.6%. Power revenue dipped 4.3% to $241.1-million, despite a 63.7% jump in volume, to 8,419 GWh.

Cost of sales fell 36.8%, but operation and maintenance surged 125% to $35.1-million.

Electric Operations (Northern Indiana Public Service) operating income improved 0.9% to $74.5-million, on net sales revenue of $257.6-million, up 4.4%, as power sales dipped 0.3% to 3,822 GWh, led by a 4.8% fall in industrial, to 2,197 GWh. Residential rose 9.1% and commercial 4.8%.

Cost of sales was up 2.9% to $69.1-million.

Gas Distribution (including the former Columbia Energy Group utilities) operating income surged 3,390% to $34.9-million, though net distribution sales revenue slumped 32.9% to $467.1-million. Cost of gas sold was down 45.3% to $291.7-million. Net transportation revenue was up 10.9% to $78-million. Throughput fell 7.2%, even though heating degree days jumped 39.8%, due to a 74.3% slide in off-system sales.

Depreciation and amortization costs were down 29.1% to $39.2-million, reflecting the end of "goodwill" amortization from the CEG acquisition, under new accounting standards.

Transmission and Storage operating income rose 18.4% to $76.6-million, on revenue of $212.1-million, down 2%. Exploration and Production operating income slipped 39.2% to $5.9-million, on revenue of $47.9-million, up 2.1%.

The operating loss on Other Operations, including assets held for sale, narrowed 59.7% to $6.4-million, on revenue of $13.4-million, down 67.6%, reflecting sale of the water operations and other disposals.

Company-wide interest costs were down 17.2% to $123.7-million. Income taxes jumped 487.5% to $14.1-million. Results also reflect the Aug. 21, 2001 sale of CEG's retail propane operations

**Entergy** net rose 1.1% to $241.6-million, on total operating revenue of $2.1-billion, down 16.3%. EPS were unchanged at $1.08 (basic) and $1.06 (diluted), on basic shares of 224,330,654 and diluted of 228,847,752, both up 1.4%.

The Competitive Business segment saw net slump 53.6% to $51.4-million, on revenue of $378.1-million, down 20.7%. Operating expenses fell 27.8% to $289.4-million, led by an 82.2% plunge in fuel, fuel-related expenses, and gas for resale, to $47.3-million.

But purchased power surged 96.2% to $25.9-million, and other operation and maintenance 60.8% to $180-million. There was also an $18.2-million (pre-tax) charge for "turbine commitments, asset impairment, and restructuring charges," which cut EPS 11 cents.

That was partially offset by a 10-cent gain on "the sale of certain assets in connection with the restructuring process."

With that, EPS from Commodity Services—the combined reporting unit of Entergy-Koch and Wholesale Operations—fell from 14 cents to 10 cents. Entergy Nuclear EPS jumped from 15 cents to 24 cents, due mainly to the acquisition of Consolidated Edison's Indian Point-2 (Sept. 6, 2001).

Also, "equity in earnings of unconsolidated equity affiliates" slid 74.9% to $17.7-million. Interest and preferred dividends was down 10.9% to $37.3-million, and income taxes 68% to $15.5-million.

Power marketing volume rose 2% to 26,877 GWh, but gas slumped 29% to 4.8 Bcf/day.

In the U.S. Utilities segment, net improved 11.2% to $194.8-million, though revenue slid 15.3% to $1.7-billion, on power sales of 26,706 GWh, up 2.1%, led by a 12%

rise in wholesale, to 2,444 GWh. Residential rose 7% and commercial 3.5%, and industrial fell 3.9%.

Operating expenses dipped 11.9% to $1.26-billion, led by a 44.2% plunge in fuel, fuel-related, and gas for resale, to $424.1-million. Purchased power was down 10.3% to $209.4-million.

But "other O&M" jumped 63% to $527-million, as previously-deferred ice storm costs were booked under a settlement with the Arkansas Public Service Commission.

However, "other regulatory credits" were $170.6-million, versus year-before charges of $13.1-million. Interest and other charges fell 16.4% to $115.3-million. Income taxes were up 18.5% to $136.5-million.

**Otter Tail** net was up 19.7% to $10.4-million, on total operating revenue of $176.6-million, up 12.2%. EPS rose from 35 cents to 41 cents, on average diluted shares of 25,411,877, up 2.5%.

Otter Tail Power net was down 13.5% to $5.5-million, as revenue rose 3.6% to $71.9-million, due mainly to a 25% slide in wholesale prices, though wholesale volume rose 28%.

Combined net from plastics, manufacturing, health services, and other operations jumped 83.5% to $5-million, on revenue of $104.7-million, up 19%.

## MOODY'S MAY CUT CLECO, CITING LINKS TO TROUBLED POWER MARKETING FIRMS

Moody's Investors Service Tuesday shifted its outlook on Cleco (senior unsecured debt Baa1) from stable to negative, citing the worsening credit quality of project finance counterparties Aquila (senior unsecured Baa3), Calpine (Ba3), Mirant (Ba1) and Williams (Ba3).

Their arrangements with Pineville, La.-based Cleco are modeled on the Cleco Evangeline project, under which Williams guarantees tolling payment obligations of Williams Energy Marketing and Trading, and the payments are the primary source of funds to repay project debt.

Moody's downgraded Evangeline senior secured from Baa2 to Baa3 on July 25 and kept it on review for downgrade, the same status as Kansas City, Mo.-based Aquila (Acadia project), Atlanta-based Mirant (Perryville project), and Tulsa, Okla.-based Williams, meaning a downgrade could be more imminent that under a negative outlook, which Moody's also has on San Jose, Calif.-based Calpine. The Acadia Power Partners project is a 50/50 venture between Cleco Midstream and Calpine.

Its outlook remains stable on utility unit Cleco Power (senior secured A2), the major source of Cleco's credit strength, noted vice president—senior credit officer Tucker Hackett.

## ONEOK-TRADING *(continued from page 1)*

can provide. We could have become an instant power merchant player," but chose not to because of the risk.

Skoog said that while the company intends to increase its trading business, it will do so in a measured way, acting in response, rather than anticipation, of growth. "There are a lot of skilled people out on the street right now, traders that we're evaluating bringing in to capture this potential increased market share."

"This environment is generating opportunities' that the company will pursue, said President and CEO David Kyle told the analysts. He added, however, that "[w]e are going to be judicious as we evaluate those opportunities."

Power marketing generated about $1-million in operating income in the second quarter, he said, compared to crude and liquid marketing of physical income of $814,000 and $7.8 million in mark-to-market income. Power sales have no mark-to-market component, he added.

ONEOK posted a 64% gain in net earnings in the second quarter of 2002, compared with the same period a year ago. Net income was $38.8-million or 32 cents/share on operating revenues of $1.17-billion, compared with $23.6-million or 20 cents/share on operating revenues of $1.4-billion for the same period a year ago.

ONEOK's had a second quarter power trading volume of 336 GWh. In the first half of this year, ONEOK marketed 652 GWh and 470,521 mMcf. Comparable 2001 figures are not available because its power production facility in West Edmond, Okla., was not fully operational. ONEOK Monday made a tender offer for $64-million of its own debt, which expires Aug. 20, but said it has not decided whether to repurchase Westar's ONEOK stock holdings under an offer that expires at the end of the month.

It said the tender offer should not be viewed as being tied to a decision on the repurchase issue. Westar has offered to sell back the stock for $21.77/share or $971 million. ONEOK would not discuss the situation further during the call. The company is maintaining its earnings guidance of $1.33 to $1.44/share for 2002.

## FERC-CALIFORNIA *(continued from page 1)*

Aug. 28-30.

Wagner told reporters he is "confident" the state will reach settlements with at least 80% of the suppliers it signed the long-term deals with last summer, though he said he doesn't believe all suppliers will be agree to modify their contracts. Those that do not settle will enter formal FERC proceedings.

He reiterated that five sellers, including Williams, reached "settlements in principle," but the terms, conditions and identities of four of the parties remain confidential.

FERC Chairman Pat Wood also told reporters yesterday that he hopes to bring the case to a close, either through settlements or hearings, by the end of the year.

Wood said the commission would be issuing an update to Congress within the next week on its investigation into alleged market misconduct during the Western power crisis of 2000 and 2001

California is seeking to overturn the more than $43-billion in power contracts it signed last year with roughly a dozen suppliers.

## WILLIAMS-NOTICE *(continued from page 1)*

business unit. Tulsa meets those criteria. Houston, which has about 20 employees in the unit, and London, which has 70, does not, a Williams spokeswoman said.

In a statement yesterday, Williams said "the notification is not an indication that specific decisions have been made about how many employees will be affected and when. The company hopes to have more information about which jobs will be affected and when the reductions will occur as staffing needs are finalized."

The company said it is continuing to seek an EM&T joint venture partner and also is seeking one or more buyers for portions of its energy portfolio. "Reductions throughout the Williams organization will also continue over time as assets are sold and business requirements are reassessed," it said.

**AQUILA-TRADING** *(continued from page 1)*

On June 17, it said it was greatly reducing its energy marketing operations and seeking a partner. Yesterday, it threw in the towel. As the year opened, Aquila Merchant Services had 1,444 employees split between EM&T and Capacity Services. It cut 150 positions in May, 370 on June 17 and another 500 yesterday, a spokeswoman said. The remaining 424 employees all are in the Capacity Services unit, she added.

"While we had explored the idea of securing a partner, we believe it is in the best interest of our shareholders to completely exit the wholesale energy marketing and trading business," Aquila President and CEO Robert Green said. He said Aquila and Chicago-based Citadel Investment Group had reached a deal to provide potential employment with the investment firm to former Aquila workers.

"Our wholesale energy marketing and trading business is operated by some of the best talent in the industry, and they have created considerable value for Aquila in the past decade," Green said. "The process of taking this business from a top-five energy marketer to a complete exit of trading has required tremendous effort and that reflects well on the professionalism and commitment of Aquila people."

Aquila common stock traded yesterday between $5.41 and $6.40, but closed unchanged at 5.74, down 14.7% in a week and 81.5% in a year.

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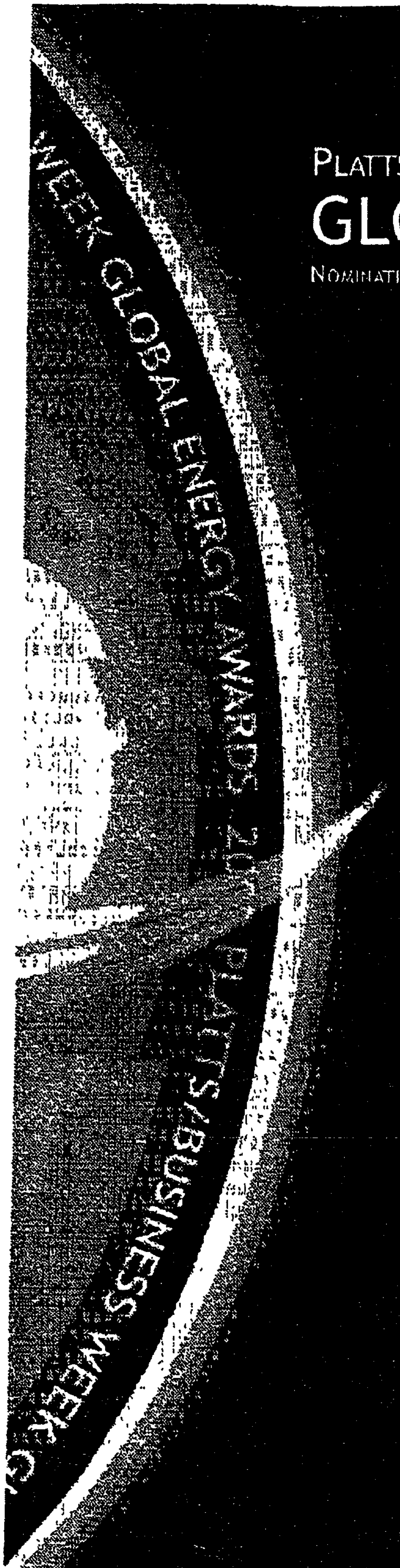


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THE WALL STREET JOURNAL.
ONLINE

July 26, 2002

EARNINGS

# Power Companies' Stocks Surge Despite Declines in Net Incomes

By MITCHEL BENSON
Staff Reporter of THE WALL STREET JOURNAL

A sharp downturn in power prices and wholesale trading activity sent second-quarter profits plunging at **Reliant Resources** Inc., its parent, **Reliant Energy** Inc., and **American Electric Power** Co.

Even so, shares of all three companies traded higher Thursday, with analysts saying that the companies' earnings weren't nearly as dire as had been feared. Reliant Resources, for example, whose stock hit a 52-week low on Wednesday, closed up $1.78, or 52%, at $5.18, in 4 p.m. New York Stock Exchange composite trading.

**POWER OUTAGES**

• AES Swings to Quarterly Net Loss, Due to Troubles in South America[1]

The Houston electricity and energy services wholesaler and retailer reported earnings of $178 million, or 61 cents a share for the second quarter, down from $229 million, or 82 cents for the comparable period last year.

**COMPANIES**

Dow Jones, Reuters

| | |
|---|---|
| Reliant Resources Inc. (RRI) | |
| PRICE | 5.18 |
| CHANGE | 1.78 |
| U.S. dollars | 7/25 |
| Reliant Energy Inc. (REI) | |
| PRICE | 8.80 |
| CHANGE | 3.40 |
| U.S. dollars | 7/25 |
| American Electric Power Co. Inc. (AEP) | |
| PRICE | 29.50 |
| CHANGE | 3.19 |
| U.S. dollars | 7/25 |

* At Market Close

The fall in earnings was primarily a result of a sharp contraction in Reliant Resources' wholesale and trading business, where pretax income fell to $31 million from $298 million in the year-earlier period.

"We have seen heat, but we've not seen the sort of prices we would have anticipated in our key markets," said Stephen W. Naeve, Reliant Resources' president and chief operating officer.

The wholesale losses were somewhat offset by gains in its retail business, which the company attributed largely to the January opening of Texas' electricity market to full competition. The company's retail energy segment reported pretax earnings of $205 million for the second quarter, compared with a $2 million loss a year earlier.

Pointing to the continued unpredictability of its wholesale markets in the U.S. and Europe, Reliant Resources cut its earnings outlook for the year to $1.65 to $1.85 a share, down from $1.80 to $2.

Reliant Resources had a tough quarter, aside from its finances. In an effort to distance itself from its embarrassing admission that it engaged in bogus power deals, the company announced a 87 management shake-up in May that included the resignations of a top group president and its head of trading.

Looking ahead, company executives said they still intend to complete the planned spinoff of Reliant Resources from Reliant Energy -- with the former parent to be renamed CenterPoint Energy -- later this year. Reliant Energy currently owns 83% of Reliant Resources.

Officials said their next big challenge is to refinance about $5 billion in bank debt that is due to mature through February. Rex Clevenger, the company's senior vice president for finance, said he was "very confident" of refinancing. By contrast, Credit Suisse First Boston analyst Neal Stein, called raising any new funds "a challenge" given how sour banks have turned on wholesale energy marketers.

Meanwhile, Reliant Energy, also of Houston, reported earnings of $236 million, or 79 cents a share, down from $316 million, or $1.08 a share for the comparable period last year. Reliant Energy's earnings reflect its approximately 83% interest in Reliant Resources.

Like its unit, Reliant Energy attributed the decrease in net income largely to a decline in the company's wholesale energy segment. Results for the second quarter of 2002 also reflected increased interest expense. Assuming completion of the spinoff of Reliant Resources, 2002 earnings per share for the segments that will comprise CenterPoint Energy are still expected to be in the range of $1.17 to $1.22, excluding its prior interests in Reliant Resources.

Reliant Energy's stock was up $3.40, or 63%, to $8.80, in 4 p.m. New York Stock Exchange composite trading.

And American Electric Power announced its earnings were down more than 90% for the quarter, due primarily to weaker energy prices and narrower profit margins in wholesale sales from its power plants. The Columbus, Ohio, power company reported net income of $21.9 million, or seven cents a share, for the second quarter, down from $231.8 million, or 72 cents a share, for the comparable period last year.

Like the two Reliants, AEP -- concerned about continued uncertainty in its wholesale market -- cut its 2002 earnings per share forecast to a range of $3.20 to $3.35, down from the previously announced range of $3.60 to $3.75.

AEP stock was up $3.19, or 12%, to $29.50, in 4 p.m. New York Stock Exchange composite trading Thursday.

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*Updated July 26, 2002*

*Saint Paul Pioneer Press June 18, 2002, Tuesday*


Saint Paul Pioneer Press

June 18, 2002, Tuesday

**KR-ACC-NO:** SP-UTILITY

**LENGTH:** 2660 words

**HEADLINE:** Minneapolis-Based Utility Firm Reunites with Spin-Off

**BYLINE:** By David Hanners

**BODY:**
If utility companies were cars, Xcel Energy would be your cautious uncle's Pontiac sedan: dependable and conservative. Its subsidiary, NRG Energy, would be more like your rakish cousin's Mazda Miata: bright red, fast and looking mighty flashy with the top down.

It looked great until it rained, that is.

In this case, the "rain" was a chain reaction of events -- from California to Houston to Wall Street -- that made a seemingly good idea in 2000 a bad one today. Minneapolis-based Xcel's 2-year-old plan to finance NRG's rapid growth by selling NRG stock came to a halt earlier this month. NRG is now back under Xcel's wing via a stock swap. "Maybe 'bitterness' is too strong a word, but we're certainly disappointed," said Dick Kelly, president of Xcel Enterprises and acting president and chief operating officer of NRG. "This will come back again. It's a cyclical business."

While Xcel was the big and steady utility company, NRG was the fresh and fast-growing upstart, generating electricity and selling it on the open market.

Analysts and business experts said that NRG's troubles had less to do with its own structure and goals than with outside factors it couldn't control.

NRG had ambitious growth plans and needed money to fuel that expansion. When the California energy crunch hit -- and that was soon followed by the collapse of Enron -- people who were in a position to lend money or buy stock suddenly soured on doling out piles of cash to energy companies.

There are some who contend that NRG -- 74 percent of which was still held by Xcel -- didn't respond to the changing market quickly enough. "It was probably a combination of both a business model problem and a business environment problem," said Arleen Spangler, a fixed income analyst with Standard & Poor's in New York.

"They had no difficulty accessing the debt market, but when it came time to access the equity market, the whole Enron thing was blowing up," said Spangler. "They were over-leveraged and it became difficult to get out of that position in the short-term."

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Rather than let the subsidiary's problems adversely affect the stock of both companies, Xcel decided to buy back the outstanding NRG stock. Investors got half a share of Xcel stock for every share of NRG they owned.

Recombining the two companies means that some jobs will be cut, although Kelly said he isn't sure how many. NRG's executive vice president and chief financial officer, Leonard A. Bluhm, has resigned. David H. Peterson, NRG's chairman, president and CEO, has retired.

It will be Kelly's job to oversee the integration of the two companies. He said he has no doubt that it is the right thing to do.

"They (NRG) made money, and they've done well," said Kelly. "They were growing at 20 to 25 percent. That was net income. It's just that the (credit) rating agencies decided that all of these companies were leveraged too high, and the stock market punished them. It became a financial issue; you couldn't finance them going forward. We've been punished along with NRG and with the stock market.

"As NRG became more risky," he continued, "Xcel became more risky. We're now on credit watch with the agencies, too."

Some business experts believe folding NRG back into Xcel may be a bumpy process. To understand why, one must first understand the different nature of the two companies and the employees they attracted. In fact, the cultures at the two companies were so different that Alfred Marcus includes a case study of Xcel/NRG in a management course he teaches at the Carlson School of Management at the University of Minnesota.

Xcel is the nation's fourth-largest energy utility, providing natural gas and generating electricity in 12 states. It was formed in 2000 by the merger of Northern States Power Co., which was based in Minneapolis, and Denver-based New Century Energies.

Its electrical plants generate more than 15,000 megawatts of electricity, roughly the equivalent of 14 Prairie Island nuclear reactors.

The company has revenues of $ 15 billion annually. It largely operates in the world of government-regulated energy generation. To do that, it has to take a generally cautious and conservative approach to growth.

Similarly, its stock price -- while experiencing some ups and downs with the market -- has remained relatively stable as those things go. Since June 2000, it's had a high of about $ 31 a share and a low of $ 20 a share.

NRG was founded in 1989 to take advantage of the unregulated energy markets. It is known as an independent power producer, or IPP. It buys and manages power plants and sells electricity on the open market.

In its heyday, NRG was in a world where the brisk and bold were rewarded. NRG and Xcel's other nonregulated businesses were once the drivers of Xcel's growth. At the annual meeting of investors in September 2000, Xcel chairman Wayne Brunetti predicted that NRG and the other nonregulated subsidiaries would account for 45 percent of the parent company's earnings by 2004.

They were different companies with different approaches, said Marcus.

"Part of the reason for spinning off a company like NRG... is it's hard to, in the same corporate structure, have a business that's aggressively growing and, at the same time, have

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a business that's heavily regulated and is a conservative and a mature business," Marcus said.

NRG was "a division that did not fit in the core business and had to move rapidly, can't be bogged down," Marcus said. "You have to spin it off and let it go."

But Xcel also wanted to spin off NRG because a couple of years ago, investors and Wall Street took a strong liking to those types of businesses, said Jim McIntyre, Xcel's vice president and chief financial officer.

"The presumption was it was more efficient from a financing point of view to use NRG's stock to finance the growth than to use Xcel's stock," he said. "The reason we did the IPO (initial public offering) back in 2000 was the strength of the currency of independent power producers like NRG was stronger than the utility currency. The IPOs were going out with a profits-earnings ratio that was stronger than on the utility side."

NRG's first public offering of stock, announced in May 2000, raised $ 454 million. The second offering, announced in February 2001, raised $ 478 million.

NRG had ambitious -- and international -- growth plans. It became the world's third-largest IPP. A blurb on the company's Web site put it plainly: "NRG is known as an aggressive, fast-moving entrepreneurial company when it comes to developing and growing our business."

Its business was wild and unpredictable, and so was its stock price. Since June 2000, its stock has been at a high of $ 38.50 a share (Sept. 29, 2000) to a low of $ 9.60, last February.

"It probably did have more of a sports car mentality. What they really needed was an F-150 pickup so they could deliver the goods and have an honest, value-added service," said Fred Zimmerman, a professor of engineering and management at the University of St. Thomas. In the past, Zimmerman has done consulting work for Xcel.

NRG had planned to grow by as much as 25 percent a year. It generated about 15,000 megawatts a year -- about the same as parent company Xcel -- and planned to expand to about 32,000 megawatts.

But as with an athlete, something has to fuel that growth. While Xcel depended on a steady and balanced diet, upstarts like NRG went the steroid route.

A company can finance growth in three main ways, using those methods alone or in combination.

It can pay for it with cash flow from its current operations. That generally doesn't lend itself to rapid growth, particularly for young companies.

It can sell itself to investors to raise money. This can be done by selling stock in the company through the stock market, or by selling to a private buyer.

Last, it can borrow money. If business is good and the firm gets a good rating from the big credit rating houses, it can borrow that money at a favorable interest rate.

If business isn't so good or if lenders think it's a risky business, the interest rate is higher and it costs more to borrow the money.

"What happened was, they were borrowing money for a lot of this growth," said Marcus. "Some of it came from equity, but a lot of it was debt. Ultimately, they hoped to be in a position where they could finance growth by cash flow. They had a plan by 2005 to use cash flow."

Money -- or rather, the interest on it -- just got too expensive to borrow. Among the reasons: California's bungled attempt at energy deregulation, mild winters in the Northeast, skittish credit rating agencies and a greedy and unscrupulous energy company in Houston named Enron.

Just when Xcel was spinning off NRG, California was getting its first taste of energy deregulation. In the past, the three elements of electrical service -- generation, transmission and distribution -- were all handled by single companies.

But under deregulation, one company produced power, another owned the transmission lines and yet a third firm acted as the retailer, selling electricity to customers.

Electricity, like most other commodities, adheres to the law of supply and demand. Power-trading firms soon discovered they could manipulate the market and drive up prices and profits by withholding electricity. This set off a string of events that led to rolling blackouts and sky-high energy prices.

It also brought about a federal investigation of energy trading practices that, in the eyes of investors and others on Wall Street, managed to tarnish companies that weren't involved. (In formal responses to federal regulators, NRG has denied that it partook in any unscrupulous deals involving electricity in California.) At the time this was happening, a string of mild winters in the rest of the country, particularly the Northeast, where NRG owns many plants, kept energy demand low. Companies that profited from providing power found themselves hurting.

Then there was Enron. The Houston energy company was one of the fastest-growing companies in the country, but it was built like a house of cards made up of bogus subsidiaries. When it declared bankruptcy last fall, it was the biggest bankruptcy filing in American history.

The Enron disaster, coupled with the California debacle, caused analysts to suddenly question whether energy companies were wise investments -- especially when those companies, like NRG, had voracious appetites for growth.

"The markets just stopped valuing that sector," said Standard & Poor's Spangler. "The equity prices of all these companies have gone through the floor. They're just not worth what they once were. Investors are just so skittish on the sector. There are so many unknowns and concerns, and every day there's a new scandal coming out. It scares investors."

"The key point was when the key credit-rating agencies came in and downgraded Enron's bonds to junk status, in November 2001, and that's when it went downhill," said Marcus. "These were the credit-watch issues. This is what hurt all these companies, and again, if you were in a position where your basic business plan is to expand rapidly, it's assuming you can purchase properties throughout the world aggressively at a low enough price that you can see a return, and then your status is downgraded, your interest rates go up because you're a higher risk to the banks, and it stalls.

"When you're talking about even half a percentage point (of interest) with billions of dollars of purchases," he continued, "it's a lot of money, and it decides whether you're going to be profitable or not profitable."

NRG has already sold off many of its foreign assets, and Xcel's Kelly said the firm will have to be satisfied with growth in the 10 to 15 percent range.

"They lived in a faster time there for about three years," he said of NRG's employees. "They're very good at buying plants, fixing them up, producing power, but a lot of them came because they were at NSP. A power plant is still a power plant. But they're not going to be as happy because we're not going at 20 to 25 percent, but at 10 or 15 percent. There aren't as many deals for them to do."

KEY EVENTS IN NRG ENERGY'S HISTORY 1989

NRG Energy is formed as a subsidiary of Northern States Power. The company is an independent power producer -- IPP -- generating electricity, then selling it on the non-regulated market, as opposed to its regulated parent utility.

--Early 1990s -- NRG grows, buying power plants across the country. Abroad, NRG takes advantage of a move to privatize energy facilities by embarking on a plan to buy power plants in Europe, Asia and the Pacific and Latin America.

--1994 -- Until now, NRG has bought existing power plants. But this year, it **buys** an interest in a new **plant** built from the ground up, a **coal**-fired facility near Leipzig, Germany.

--1996 -- NRG continues its buying spree, and is listed by McGraw-Hill as the world's 22nd-largest independent power producer when measured in megawatts produced. Among the deals it announces: plans to become a joint owner and operator of Estonia's national electric system. The subsidiary accounts for about 12 percent of parent NSP's earnings.

--1997 -- As NRG's business and influence continues to grow, NSP announces that it is considering a partial spin-off of the subsidiary. NRG enters the soon-to-be deregulated California market by joining with another firm to buy a Southern California Edison electric plant near Los Angeles. Half a world away, NRG buys 25 percent of the previously government-run Loy Yang A power station in Australia. At the time, the deal is the largest privatization of an energy asset in the world.

--1999 -- NRG becomes one of the largest IPPs in the Northeast when it acquires a string of power plants in New York, Connecticut and Massachusetts.

--2000 -- NRG expands its operations in the Northeast, Louisiana, Australia, India and Taiwan. In May, NSP announces an initial public offering of NRG stock; it will raise $ 454 million. In August, NSP mergers with Denver-based New Century Enterprises, and the new company is named Xcel Energy. At Xcel's shareholder meeting in September, company chairman Wayne Brunetti say NRG and other nonregulated businesses account for 20 percent of Xcel's earnings by the end of the year.

--2001 -- California residents find that their legislature's attempt to deregulate the energy industry contains some serious flaws. There are energy shortages, rolling blackouts and the price of electricity goes sky-high. Wall Street loses its excitement over fast-growing energy stocks like NRG. In February, NRG issues a second stock offering; this one raises $ 478 million. NRG acquires more than 5,600 megawatts of generating capacity in the northern, southern and central **United States.** It also began construction or acquired plants in Britain and Hungary. In early December, Houston-based energy trader Enron, once the darling of the electric power industry, files for bankruptcy; the move causes stock and bond analysts to further devalue energy stocks. At about the same time, Moody's Investors Service places NRG's senior unsecured debt on review for a possible downgrade. On Dec. 13, Xcel announces it will plug $ 300 million into NRG.

--2002 -- In early February, Xcel decides to buy back the outstanding shares of NRG. The shares amount to 26 percent of the company. At the same time, Brunetti announces an austerity drive at NRG that would slash spending by $ 3 billion this year. Some assets will be sold, new projects will be cancelled and others would be delayed. In May, the SEC gives its approval, and Xcel begins buying back the stock.

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**January 16, 2002**

**SPECIAL REPORT:**
**U.S. Power Production Scorecard:**
**Who Is Building New Power Plants, And Where? What Fuel Sources Will Be Used?**

**By Will McNamara**
**Director, Electric Industry Analysis**

[*News item from Reuters*] Duke/Fluor Daniel has been awarded contracts to build three natural gas-fired power plants with a combined capacity of 2,240 MW in the Western United States, Duke Energy said in a statement on Jan. 14. The projects are: the 600-MW Luna Energy Facility in Luna County, N.M.; the 620-MW Grays Harbor Energy Facility in Grays Harbor County, Wash.; and the 1,200-MW Moapa Energy Facility in Moapa County, Nev. Construction is already underway on the projects.

**Analysis:** This announcement from Duke Energy jumped out at me, particularly when it is placed within the broader context of a market that is not particularly supportive of unregulated power projects at this point in time. The announcement raises many questions. When so many pure-play merchant companies are canceling planned power projects in an effort to cut back capital spending and pare down debt, what factors have enabled Duke Energy to continue with these development plans, along with several others? From a broader perspective, in the shadow of claims about a national energy glut, which may or may not have a basis in reality, are there any ascertainable trends around the power projects that are proceeding? Which companies are maintaining production levels, and how are they managing their risk exposure? In which regions of the United States are the planned power projects most likely to be located? What fuel sources are most commonly used? Which factors, beyond the economic challenges unearthed by the Enron collapse, will continue to overshadow new power projects? This article will address and attempt to answer these questions.

***Market Player Assessment***

In the wholesale power market, the leading developers of new power plants are merchant energy companies that build power plants, the output of which is not committed to a designated customer base but rather sold on the open market, often out of the state in which the plant is located. Over the last two years, high wholesale electric prices boosted the confidence that Wall Street and creditors shared for the merchant business and their plans to add as much as 290,000 MW of generating capacity over the next six years (a 40-percent increase over the capacity of 802,000 MW for summer 2001, according to NERC). However, within the wake of the Enron collapse and softening wholesale prices, a good number of energy merchant companies (particularly those that are considered pure-play companies, or those focused singularly on the merchant business) have seen their credit ratings downgraded. Generally speaking, merchant companies depend on the ability to raise capital by selling securities, capital that is then used to support further growth through asset expansion. Most reports I've seen indicate that a new natural-gas fired combined-cycle plant costs between $500 and $600/kW or over $500 million per 1,000-MW plant. Due in part to their heavy debt loads that already exist, some of the pure-play companies faced a credit-rating downgrade that put them below investment grade. Thus, in an effort to strengthen their balance sheets and pare down debt, companies such as Mirant, Calpine and Dynegy have announced plans to scale back their once-aggressive plans to expand their generating capabilities. They may still grow, but the growth will be much more conservative and slower than previously projected.

The result is that power plants, oil and gas properties with proven reserves, and even refineries may soon go on the auction block as only those companies with strong cash resources remain heavily in the game. Consequently, I think it is no coincidence that a company such as Duke Energy is proceeding with power projects while pure-play companies are announcing cancellations. Duke Energy, an integrated company with a regulated utility that provides a steady steam of revenue, has a market capitalization of $30 billion (compared to Calpine at $4.5 billion, Mirant at $5 billion and Dynegy at $8.7 billion). The point of this? Duke has the money to spend, along with a higher credit rating than most of the pure-play merchant companies, and appears to be maximizing its opportunity to build its generation portfolio while other companies remain more stagnant or are forced to sell off assets. Duke is not the only company moving forward in the

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unregulated power space, but the other companies doing the same thing also tell a similar story. Constellation Energy, which had planned to spin off its unregulated power business from its regulated utility Baltimore Gas & Electric but recently announced its intent to remain integrated, just disclosed that it has over 15,000 MW of generating capacity in late-stage development, under construction, or operating across the country. FPL Energy, which owns the regulated utility Florida Power & Light, announced that it is in the process of building two natural gas-fired merchant plants, which reportedly will add about 2,324 MW to the Texas grid. Although FPL Energy's $10-billion market capitalization is small when compared to Duke, it is still larger than the average pure-play merchant company.

Thus, I conclude that integrated companies will be in a stronger financial position when compared to pure-play merchant companies, at least for the near term until the credit problems and resulting difficulties in raising capital begin to abate for the pure-play companies. As a result, I think we will continue to see a growing number of integrated companies capitalizing on their strong financial standings and leading any new generation projects that might be announced in the next few years. By the same token, we will probably see an increase in cancellation announcements from the pure-play merchant companies, who may need to terminate power projects to pare down debt.

***Region Assessment***

There are still plenty of regions within the United States where generation is needed, due to factors like transmission constraints and comparatively high demand growth. Within this group I would include states such as California, and possibly Pennsylvania and Texas. Note that Pennsylvania and Texas typically have had comparatively easy siting regulations, which have made it easier for companies to build new power plants in those states. The high level of interest among merchant energy companies now has caused concerns about over capacity in Pennsylvania and Texas. In California, despite recent conservation efforts in the aftermath of the state's energy crisis, demand continues to increase. However, California has had a notoriously difficult siting process for new power plants and also faces deficiencies in its transmission infrastructure, which can make it difficult for generating companies to find a suitable location for a generation facility.

Looking at the 10 NERC regions individually, we see that some regions offer greater opportunities for merchant power production than other regions. Space does not permit me to offer a thorough analysis of each region, but here are some key points that should be noted, especially regarding each particular region's reserve margin and the typical fuel sources that have been included in the region's generation portfolio. On average, reserve margins of 15 percent are considered the reliability target that most regions strive to maintain. Anything lower than that certainly indicates potential problems with deficient supply, and even reserve margins in the high teens indicate that the regions should have new

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