Analyst:
Todd A Shipman, CFA, New York (1) 212-438-7676
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NEW YORK (Standard & Poor's) Nov. 6, 2003--The U.S. Federal Energy Regulatory Commission (FERC) recently finalized its rulemaking originally aimed at reining in the transfer of cash between regulated pipeline subsidiaries and their unregulated parent companies. Although the new rule helps to clarify many of the lax record-keeping practices of the past, Standard & Poor's does not believe the FERC has erected any barrier between the utilities it regulates and their affiliates to warrant any change in the consolidated approach now taken with the credit ratings of each.

The FERC's move was in response to the actions of Enron Corp. in the weeks leading up to its bankruptcy filing, when it tapped its two regulated natural gas pipelines for $1 billion in an effort to stave off its liquidity crisis. The FERC rule has credit rating implications in that it raises the possibility that the regulatory oversight by the FERC could rise to a level that would support an analytical judgment that FERC-regulated entities covered by the new rule are insulated from their parent corporation, and thus could support a ratings differential between the two. The elements that determine whether regulatory insulation exists are numerous and complex, but to summarize the most important ones: the strongest case for regulatory insulation exists where there are tight, statutory-based restrictions on cash or asset transfers with real consequences for violations, coupled with active, pre-emptive oversight by the regulatory body.

On the first point, the FERC at first planned to impose a minimum common equity balance of 30% and a requirement that the pipeline company and its parent maintain investment-grade credit ratings to participate in cash-management programs with affiliates. While the minimum equity balance is not particularly protective (it would not support even an investment-grade rating at a typical pipeline business risk score), at least the minimum credit rating requirement added some marginal credit-related discipline to the regulatory mix. However, the FERC backed away from even those relatively mild demands in the final rule, and instead opted to only ask the companies to notify the commission each quarter if their equity ratio falls below the 30% mark.

As to the second point, the degree of oversight by the FERC has traditionally been viewed as being less than sufficient to justify insulation, and nothing has changed in that regard because of the proposed new rule. That the FERC took almost two years to respond to the Enron pipeline situation indicates that timely intervention that would protect bondholder interests is not likely when a regulated utility's parent is experiencing financial problems. It seems clear to Standard & Poor's that the new rule falls far short of providing the requisite insulation to justify any ratings separation for utilities regulated primarily by the FERC.