

September 25, 1996

To: Dale Ruhter  
From: Rick Nevin, Bill Goldberg, and Darius Brawn  
Subject: Bond Ratings and Investment Grade Status

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The purpose of this memorandum is to determine the debt ratings on financial test firms and to discuss several issues regarding these ratings as they relate to the proposed financial test. Using handbooks obtained from Standard & Poors (S&P) and Moody's<sup>1</sup>, ICF compiled a comprehensive list of firms whose debt has been rated and who own or operate (directly or through subsidiaries) a Subtitle C or D facility requiring financial assurance. The complete list of these firms and their bond ratings is presented in Attachment One. For firms with ratings, ICF collected information on both their senior debt rating, and the rating of their most recent debt issue. This memo analyzes the consequences of variations between these two ratings, and any evidence of rating variations between Moody's and S&P.

### **Interpreting Reported Bond Ratings**

Senior debt ratings from S&P's handbook were easily identifiable. Attachment Two shows the format used by S&P, which clearly identifies (in bold) the overall "senior debt rating" for each firm, without reference to any specific bond issue. The ratings for specific bond issues are listed beneath the overall corporate rating. Senior debt ratings for Moody's were not as easily identifiable. ICF's initial discussions with Moody's representatives indicated that the first issue listed, as shown in Attachment Three (i.e., the listing that is not indented), represents the highest rated debt for the firm. As a result, ICF collected the bond ratings for these issues. However, follow-up consultations with Moody's revealed that the first issue should **not** be considered the most senior debt, and that bonds are listed in order of maturity (i.e., the bonds are listed from earliest to latest maturity dates). This discrepancy does not present a major problem, however, because the first issue listed for each firm in the Moody's directory is generally equivalent to S&P's overall senior debt rating. Therefore, the first issue rating listed by Moody's is shown in Attachment One as the "senior debt rating" from Moody's.

### **Firms with Only Secured Debt Ratings from Moody's**

For some of the companies listed in Attachment One the Moody's debt rating could not be cross-checked with S&P's senior debt rating because S&P had no information on these companies. Moody's ratings for these companies were examined more closely to determine whether the rated debt was unsecured or secured. For those companies whose debt was listed as **unsecure**, the rating provided by Moody's could be considered a reasonable approximation of the company's overall senior debt rating. However, for those companies whose debt was listed as **secure**, the rating provided could not be considered a "fair"

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<sup>1</sup> Moody's Bond Record, July 1996 and Standard & Poor's Ratings Handbook, August, 1996.

approximation of the company's overall debt rating. This is because secure debt is backed by collateral which creditors can claim in the event of default. Secure debt, therefore, increases the likelihood of a company being able to honor its bonds even if the company itself were at risk of bankruptcy. Consequently, secure debt is likely to overstate a company's unsecured bond rating. Exhibit One presents the ratings for companies with only secured debt rated by Moody's, and no debt rated by S&P.

**Exhibit One  
Moody's Ratings for Secured Debt  
Issued by Firms Not Rated by S&P**

COMPANY NAME	MOODY'S SECURED RATING
Beazer East Inc	A3
Central Hudson Gas & Elc Corp	A3
Eagle-Picher	Caa
Rochester Gas and Elc Corp.	Baa1
San Diego Gas & Electric Co.	A1
White Consolidated Industries	Baa2

The firms presented above are likely to have overall credit ratings that are slightly lower than the secured ratings provided by Moody's. However, it can reasonably be inferred that the overall credit ratings for Beazer East Inc, Central Hudson Gas and Electric Corp., and San Diego Gas and Electric Company will still be of investment grade quality (Baa or higher). While these firms do not have unsecured debt that is rated by Moody's, their secured debt ratings are high enough to suggest that their overall credit ratings are still investment grade quality (i.e., they would pass a bond rating requirement based on unsecured debt ratings). Conversely, Eagle-Picher's secured rating is only Caa, and an unsecured bond rating could only be lower, indicating that Eagle-Picher would not be able to pass any investment grade bond rating requirement. Rochester Gas and Electric Corp., and White Consolidated Industries have secured bond ratings that are investment grade quality, but it is unclear whether or not their overall credit rating would also qualify as investment grade. For the purpose of ICF's ongoing financial test analysis, the secured debt ratings shown above will be applied under the bond rating alternative. This is consistent with the current language for the bond rating alternative, which refers to the rating on a firm's most recent bond issue.

**Summary of Senior Debt Ratings versus Most Recent Debt Issue Ratings**

Attachment One also shows the most recent debt issue ratings for those financial test firms that have a rating on their most recent issue that is not the same as their overall senior debt rating. Exhibit Two (below) presents a summary of the bond rating in Attachment One. There are 439 financial test firms with senior debt ratings from S&P, Moody's, or both. Of these, 341 firms have investment grade senior debt ratings from at least one of the two rating agencies (i.e., a rating of BBB or higher by S&P and/or a rating of Baa or higher by Moody's). For 112 of the 439 firms with bond ratings, the most recent debt issue had a different rating than the firm's senior rating. In 6 of these 112 cases, using the firm's most recent debt issue rating for the financial test would affect the firm's ability to pass the bond-rating requirement.

**Exhibit Two  
Breakdown of Credit Ratings**

	<b>Investment Grade</b>	<b>Non-Investment Grade</b>	<b>Total</b>
<b>Financial Test Firms with Senior Debt Ratings (Either S&amp;P or Moody's or both)</b>	341	98	439
<b>Number of Firms With Senior Debt Rating not Equal to Most Recent Issue</b>	61	51	112
<b>Rating Used in Test Affects Firm's Ability to Pass Bond-Rating Requirement</b>	5	1	6

Exhibit Three shows the six firms that could be affected by a regulatory change that specified “senior, unsecured” ratings rather than the “most recent” bond ratings as the criteria for the financial test. In one case, Southern Pacific Transportation Co., the most recent bond rating is higher than the senior bond rating and the firm can meet the requirement despite having a senior debt rating that is not investment grade. In this case, the most recent bond rating is higher because it is secured by some type of collateral.

**Exhibit Three  
Firms with Different Ability to Pass Bond-Rating Requirement  
for Senior Debt versus Most Recent Issue**

<b>Company</b>	<b>Senior Debt Rating</b>		<b>Most Recent Issue Rating</b>		<b>Type of Most Recent Debt</b>	
	<b>S&amp;P</b>	<b>Moody's</b>	<b>S&amp;P</b>	<b>Moody's</b>	<b>S&amp;P</b>	<b>Moody's</b>
Amsco International Inc.	BBB-	N/A	BB+	N/A	Subordinate	N/A
Blount International Inc.	BBB-	N/A	BB+	N/A	Subordinate	N/A
McDermott, Inc	BBB-	N/A	BB+	N/A	Subordinate	N/A
The Scotts Company	BBB-	Ba3	BB+	Ba3	Subordinate	Subordinate
Tosco Corporation	BBB-	Baa3	BBB-	Ba1	Unsecured	Unsecured
Southern Pacific Transportation Co.	BB+	Ba1	BBB+	Baa1	Secured	Secured

Using a firm’s most recent bond rating causes five firms to fall below investment grade, thereby failing the bond rating requirement despite having senior debt ratings that are investment grade. Four of these firms have lower rated recent issues because their most recent issues just happen to be subordinated debt. The last firm, Tosco, may have a lower rating on its most recent issue because the first issue listed by Moody’s (which we have used to approximate the senior debt rating from Moody’s) has a remaining term to maturity that is shorter than the term of the most recently issued bond (the Tosco issue is identified by the arrows on

Attachments Two and Three). This may occur because the likelihood of firm failure tends to be smallest for bonds with the earliest maturity dates. These bonds are more likely to be honored, and hence have a higher rating, because there is less uncertainty, or risk of bankruptcy in a firm's near future, and relatively more uncertainty or risk associated with later maturity dates.

### Comparison of Moody's and S&P Ratings

Only nine firms in Attachment One have a senior debt rating below investment grade status by one rating service and above investment grade status by another. Exhibit Four presents a summary of the most recently rated debt issues for these nine firms.

#### Exhibit Four Senior Debt Ratings where Moody's and S&P Appear to Disagree

Company	Most Recent Issue Rating		Most Recent Issue Date	
	S&P	Moody's	S&P	Moody's
Arvin Industries	BBB-	Ba1	2-9-94	2-9-94
Connecticut Yankee Atomic Power Co.	BB+	Baa3	6-24-96	6-1-88
Fisher Scientific Int'l	BBB	Ba2	12-15-95	12-15-95
Long Island Lighting Company	BBB-	Ba1	6-8-94	6-8-94
Marathon Oil Company	BB+	Baa3	9-30-93	10-12-76
PDV America Inc.	B	Baa3	2-23-96	7-22-93
Teledyne	BBB	BA3	6-21-94	6-1-80
The Scotts Company	BBB-	Ba3	7-12-94	7-12-94
USX Corp.	BB+	Baa3	5-10-94	6-29-93

The financial test, as it currently stands accepts a Moody's or S&P rating on the most recent rating as an indication of whether a firm could pass. Therefore, four of the firms listed above (Arvin Industries, Fisher Scientific, Long Island Lighting, and the Scotts Company) would pass the financial test because their most recent issue has an investment grade rating from S&P even though their Moody's rating for the same debt issue is below investment grade. Teledyne would also pass the financial test because its most recent issue has an investment grade rating from S&P even though its most recent Moody's rating for a much older debt issue is below investment grade. The other four other firms (Connecticut Yankee, PDV, USX, and Marathon Oil) would fail the financial test because their most recent issues have ratings below investment grade from S&P even though their most recent Moody's ratings for older debt issues are above investment grade.

The issue dates for the Connecticut Yankee, Teledyne, USX, PDV, and Marathon Oil bonds rated by Moody's should not be interpreted as an "old" ratings, because both S&P and Moody's update and adjust ratings for specific debt issues. Therefore, Moody's and S&P also appear to disagree on the credit quality of these debt issuers.

**ATTACHMENT 1 OF THIS MEMORANDUM MAY BE DOWNLOADED FROM THIS WEB SITE.**

**ATTACHMENT 2 OF THIS MEMORANDUM IS ONLY AVAILABLE IN THE PAPER DOCKET.**