IGCC OUTLOOK

WALL STREET PERSPECTIVE ON IGCC TECHNOLOGY

CONFIDENTIAL | JULY 2004

PRELIMINARY | SUBJECT TO FURTHER REVIEW AND EVALUATION

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Executive Summary

Attractive Market Conditions for Power Sector

- Utilities and others in the power sector have taken advantage of historic low interest rates and credit spreads in 2003 and 2004 YTD
- The power sector now has access to alternative forms of capital in the high yield and B-loan market
- Project finance markets have largely recovered from 2002 but investors / lenders continue to be cautious on merchant risk

Equity Investors

- IGCC has significant growth potential
  - High natural gas prices
  - Tightening environmental standards
  - Increasingly competitive capital costs
- Challenges for project developers include financing issues, complexity of operational model and lack of clear project development roadmap

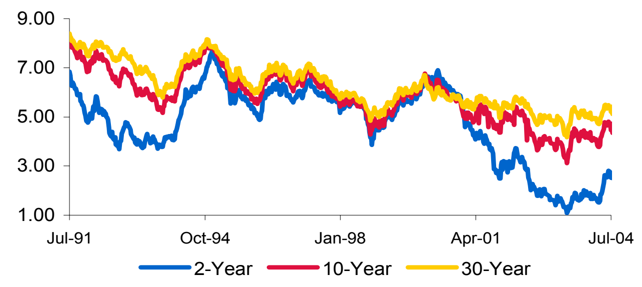
Debt Investors

- Rating agencies are skeptical of IGCC due to concerns about capital costs, start-up period and performance post-completion (particularly availability)
- Credit story for IGCC should emphasize the PPA and / or cost recovery mechanics, with added diversification benefits from IGCC's flexible production process
- Single most critical financing issue: overcoming technology / integration risks, definition of adequate completion / performance tests, particularly availability tests

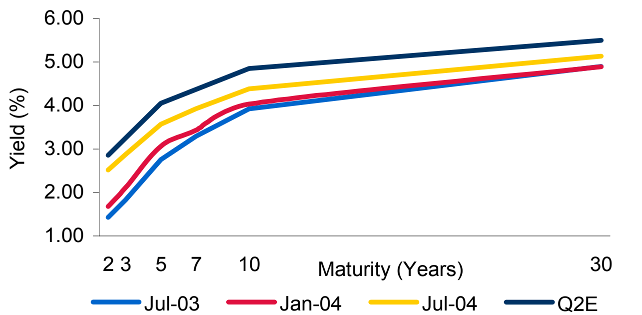
Power Industry Capital Markets Update

Current Interest Rate Environment

Treasury Market



Historical Yield Curve



Historical Treasury

Distribution of Treasury Yields (March 4, 1977 – July 16, 2004)

	5-Year		10-Year		30-Year	
Range	Freq.	Cum.	Freq.	Cum.	Freq.	Cum.
Below 6.0%	30.4%	30.4%	26.3%	26.3%	21.4%	21.4%
6.0 – 6.99%	18.6%	49.1%	14.0%	40.3%	14.5%	35.9%
7.0 – 7.99%	11.6%	60.7%	15.9%	56.2%	18.0%	54.0%
8.0 – 8.99%	12.7%	73.4%	15.1%	71.3%	17.2%	71.1%
9.0% or higher	26.7%	100%	28.7%	100%	28.9%	100%
Treasury yields as of 07/16/04:		3.57%		4.38%		5.13%
% at or below current levels:		6.45%		6.17%		6.24%

Interest Rate Environment

- Last week U.S. Treasuries rallied 2 to 10 bps across the curve on the back of weaker than expected inflation numbers. The month-over-month number for both overall PPI (–0.3% vs. 0.2% expected) and core CPI (0.2% vs. 0.1% expected) represented anti-inflationary signals to the market, pressing the 10-year UST to 4.35%, 10 bps tighter than the previous week's close
- Other catalysts for the Treasury rally
  - Addition of 40K more initial jobless claims from the previous month (349K vs. 309K)
  - Slowdown in industrial production (-0.3% vs. 0.9% the previous month)
- CSFB forecasts the Fed to increase rates by 25 bps over the next three FOMC meetings, and does not predict more aggressive tightening unless inflation rises faster than anticipated

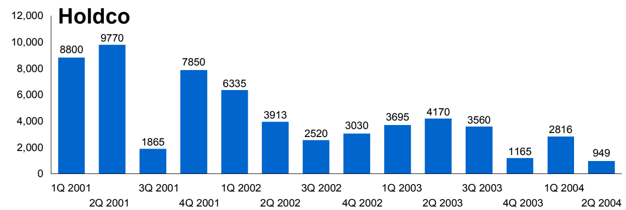
CSFB's Current Interest Rate Forecast

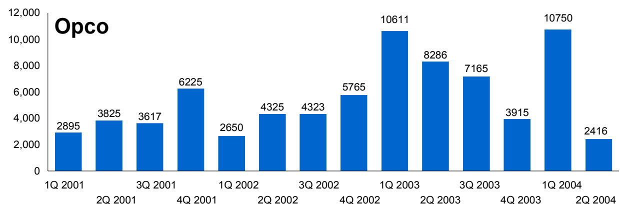
	7/16/2004	Q3 2004	Q4 2004	Q1 2005	Q2 2005
Fed Funds	1.25%	1.50%	2.00%	2.50%	3.00%
2-Year	2.50%	2.90%	3.00%	3.12%	3.25%
5-Year	3.54%	3.90%	3.95%	4.05%	4.15%
10-Year	4.35%	4.75%	4.80%	4.75%	4.65%
30-Year	5.12%	5.45%	5.45%	5.20%	5.05%

Corporate Market Environment – Utility Issuance Trends

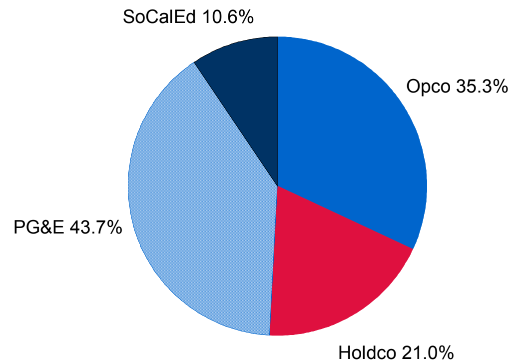
Holdco vs. Opco Issuance

($ in millions)





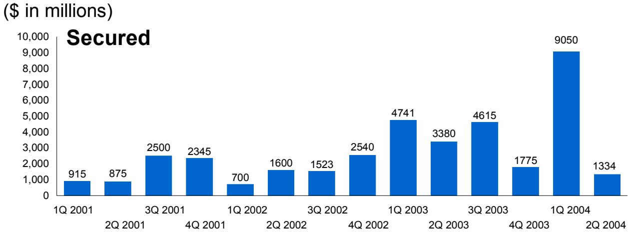
Holdco vs. Opco 2004 YTD Issuance

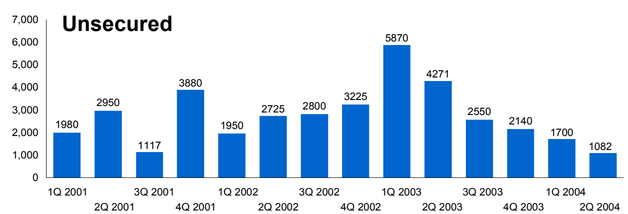


Opco Total	$5,781
Holdco Total	$3,225
PG&E (Opco)	$6,700
SoCalEd (Opco)	$1,625

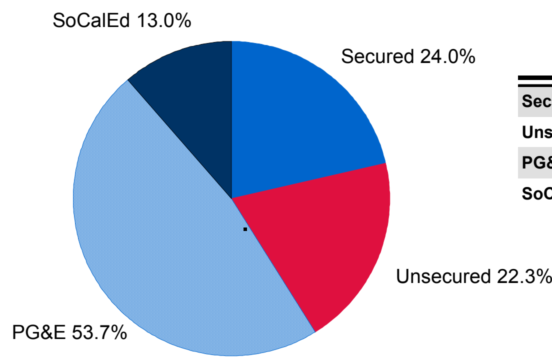
Secured vs. Unsecured Issuance

($ in millions)





Secured vs. Unsecured 2004 YTD Issuance



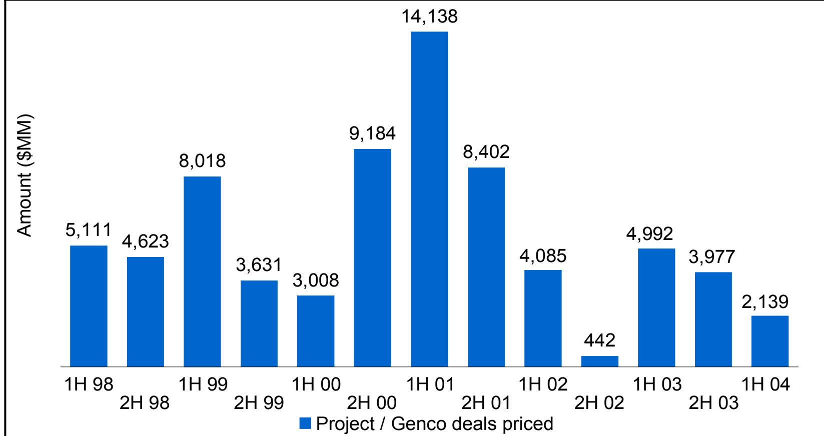
Secured	$2,999
Unsecured	$2,782
PG&E (Secured)	$6,700
SoCalEd (Secured)	$1,625

U.S. Project Funding – Capital Markets Overview

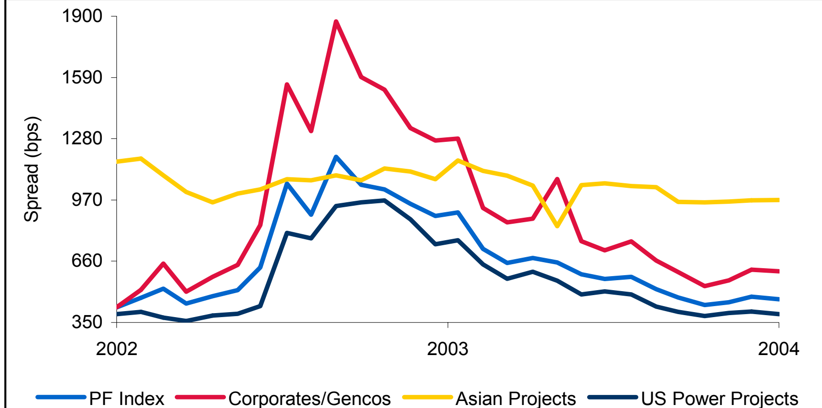
Market Overview

- Limited recovery of new issue activity in 03/04 YTD following 02 slowdown
  - ~$3.7 billion of new issuance each half over the period 03-04 YTD
  - Investment grade new issue volumes in 04 YTD trail 03 levels
  - Current activity levels in new issue presently subdued
  - Interest could be rebuilding in 05 and beyond
- Improving credit quality throughout the project sector
  - Secondary market prices have largely recovered
  - All but a limited number of projects now trading at a premium to par
- Extremely favorable spread environment for new issue
- New issue levels continue to outperform outstanding issues as investors have found it nearly impossible to acquire sizeable positions in the secondary market
- Massive appetite for low to mid-BBB structured paper, with project finance one of the few asset classes offering incremental yield / low risk profile

Historical Project Issuance (Power and Energy)



Project Market Performance



Source: CSFB Project Finance Index (PFI)

Commercial Bank Market

- The commercial bank market for utilities is extremely favorable
  - Long dated maturities (out to 5 years) are available for holding company revolvers
  - Large oversubscription for most recent revolver renewals
  - Pricing has come in after topping out in 2001 and 2002
  - Investment banks have replaced European and Japanese banks that left the sector in 2001 and 2002
- The commercial bank market for projects is improving
  - Banks are slowly returning to this market
  - Low treasuries and spreads have pushed many Sponsors to the bond market (Tri-State)
  - B-Loan lenders are stepping up for projects (Astoria)

The commercial bank market provides the lowest cost of funds but for short maturities.

Alternative Sources of Capital

Merchants, distressed utilities and certain projects have tapped the high yield and B-loan markets in 2003 and 2004 YTD

- Merchants have applied proceeds to term out near-term bank maturities
- Financial sponsors using these as acquisition currency
- Sole source of capital for non-investment grade project credits

High Yield Capital Markets

- High yield investors now understand regulated and merchant power business models
- Combination of low treasury rates and tight credit spreads
- Continued funds flow into high yield mutual funds indicates that the market could remain white-hot

B-Loans

- Non-traditional lenders including insurance companies and hedge funds
- Provide funded term loans at LIBOR spread
- Potential replacement for traditional pro rata lenders

The high yield and B-loan markets are attractive alternative sources of capital for the power sector.

What's Getting Done?

Outlook for the remainder of 2004

- The investment grade market remains white-hot for corporate utility issuance
  - Strong demand across the yield curve
  - Preference for primarily regulated businesses
- Alternative sources of capital are now widely available to the power space
  - High yield investors understand the industry – have cash to put to work
  - B-loan investors continue to replace traditional banks in certain circumstances
- The project markets are expected to remain robust
  - Credit spreads for new issuance have tightened significantly in the past year
  - Lenders more willing to assume construction risk
  - Bank market appetite is coming back
- Investors remain cautious on merchant risk

The capital markets are expected to remain wide-open for the utility sector in 2004, but investors continue to be cautious on merchant risk.

IGCC Financing Considerations

IGCC Financing Considerations – Overview

Attitudes to risk drive perception of IGCC

Equityholder Orientation	Debtholder Orientation
▶ Maximization of return on equity ▶ Diversification to improve earnings and growth potential ▶ Innovation to generate additional growth and create new markets ▶ Willing to take project development and construction risk	▶ Ability to meet repayment obligations ▶ Maintenance of strong, stable credit ratios ▶ Reliance on creditworthy counterparties and well structured contractual arrangements ▶ Reliance on proven technologies with precedents ▶ No project development risk ▶ Will take project construction risk if properly mitigated

Equity investors look for upside potential. Debt investors focus on downside protection.

IGCC Financing Considerations – Growth / Upside Potential

IGCC has significant growth/upside potential…

Macro/Portfolio Considerations	Micro/Project Considerations
▸ High natural gas prices ▪ Rising finding costs / accelerating production declines ▪ Sustained higher prices for natural gas have changed the economics of gas-fired plants ▪ IGCC economics more favorable for gas prices above $4 per MMBTU ▸ Tightening environmental standards ▪ Mercury: expected by the end of this decade ▪ Carbon: timing uncertain; likely to vary significantly among states ▪ NOx, SOx and particulates: currently regulated	▸ Best thermal efficiency amongst coal plants ▸ Improving capital costs ▪ Declined by $1,000 per kW over 1984-1995 ▪ Currently ~ $1,200-$1,500 per kW ▸ Operational flexibility / diversified revenue streams ▪ Fuel flexibility (range of low grade fuels) ▪ Sale of by-products and ancillary services ▸ Input and output optionality ▪ Coal, pet-coke and other inputs ▪ Electricity, gas and other outputs ▪ Appropriate in volatile gas price environment

IGCC Financing Considerations – Growth / Upside Potential

… held back by financing issues, a more complex operational model than conventional power plants, and the lack of a clear IGCC project development roadmap

Development

- Design costs
- Permitting
- PPA approvals

Construction

- Capital cost
- Integration risks - EPC wrap
- Continued evolution of technology
- Turnkey responsibility
- Mitigate construction risk and allocate risks to parties best able to handle

Start-up & Operation

- Ramp-up period
- Availability
- O&M costs

IGCC Financing Considerations – Credit Concerns

The rating agencies remain skeptical of IGCC…

"Although projects have been proposed using IGCC technology, which offers the best thermal efficiency and environmental performance, Standard & Poor's is not optimistic about the prospects for this technology because it is very expensive and has the poorest commercial record with low availability, high O&M costs, and long start-up times."

— *Standard & Poor's*

- Perception that technology is somewhat unproven
  - Capital costs
  - Performance reliability
- Likely to result in increased business profile score
- Reduces debt capacity and / or increases cost

Core issue is high perceived business risk.

What Do Investors Want?

Structuring

- Mitigate construction / technology risk
- Built-in liquidity for outages / lower than expected availability
  - Operating reserve
  - Guarantees
  - Step-in obligations for sponsor

Secure Long Dated Contracts

- PPAs or rate base
- Any merchant period must pass the agency's discount-to-breakeven and net revenue test

Ratings

- Investment grade ratings
- A private placement could be possible with one rating or even an NAIC-2 designation

Other

- Educate investors on risks / benefits of IGCC
  - Capital costs
  - Availability / Operating risk
  - Low emissions
- Must demonstrate high availability

Key Construction and Operating Risks

Construction

- Fixed price, turnkey, fully wrapped EPC contract with experienced and creditworthy contractor
- Performance guarantee covering entire plant, including gasification island
- Conventional commissioning / completion tests adjusted to reflect IGCC ramp-up period
- Performance and delay damages based on milestone approach
- Aggregate liquidated damages at least comparable to other project financed IPPs

Ramp-Up/ Availability

- Plant designed to maximize availability
- Guarantee of availability throughout ramp-up
- Liquidated damages if availability tests are not met
- Mechanisms to cover cash shortfalls and cost overruns (e.g., insurance, liquidity facilities, reserves, guarantees)

Revenues

- Long-term PPA with utility for plant capacity and output
- Staged, flexible increases in PPA availability requirements during ramp-up
- By-products sold under contracts to generate stable additional revenue stream
- By-products exempted from solid waste permitting requirements

Environmental/ Regulatory

- IGCC-specific permitting requirements and environmental standards
- No grey areas / overlay of permitting / environmental regulations
  - Chemical / power plant
  - Coal- / gas-fired power plant

Critical financing issues arise around the time of completion. Tests for completion and commercial operation need to be redefined to accommodate IGCC's ramp-up period.

Potential Debt Financing Sources

Capital Markets - Investment Grade

Advantages
- Extended maturities (25+ years) available
- Somewhat greater covenant flexibility
- Treasury and spread market remain very robust
- Eliminates refinancing risk

Disadvantages
- Negative arbitrage
- Limited prepayment flexibility
- Requires two investment grade ratings
- Long-dated PPAs help
- Public disclosure

Capital Markets - High Yield

Advantages
- High yield investors have rushed into the energy space (pipelines, E&P)
- Incurrence covenant package

Disadvantages
- Investor base not used to structured financings
- Investors easily scared off by regulatory/ technical risk

Commercial Bank Market

Advantages
- No credit ratings required
- Drawdown, prepayment and repayment flexibility
- Generally lowest cost

Disadvantages
- Refinancing Risk
- Typically shorter maturities (2 years)
- Lengthy syndication process (fewer investors)
- More restrictive covenants
- Bank market for power has contracted after industry woes

B-Loan

Advantages
- Market will take construction risk
- 5 to 9-year tenor
- “Red hot” market conditions
- Flexible amortization schedule

Disadvantages
- Refinancing risk
- Negative carry of pre-funding construction
- Modest pre-payment premium
- Generally needs two credit ratings

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