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NRRI Fellow  
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Investor-Owned Utility Securitization:  
Debt for Equity

Utility securitization is like a breakfast of eggs and bacon.  

*The chicken is involved but the pig is committed.*  

*In utility securitization, the utility is involved but the ratepayer is really committed.*
Our Experience in Investor-Owned Utility Securitization, Ratepayer-Backed Bonds: 19 years, Multiple Engagements; Same Personnel Have Advised 6 Commissions, 13 Transactions, $9.02 Billion in Bonds involving 8 utilities, 25+ Underwriters

<table>
<thead>
<tr>
<th>Size of Offering $ Millions</th>
<th>State Utility Regulatory Agencies, Ratepayers and Securitization</th>
</tr>
</thead>
<tbody>
<tr>
<td>N/A</td>
<td>Financial Advisor to Chairman of New York State Public Service Commission</td>
</tr>
<tr>
<td>$748.9</td>
<td>Financial Advisor to Public Utility Commission (PUC) Texas</td>
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<tr>
<td>$797.3</td>
<td>Financial Advisor to Public Utility Commission Texas</td>
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<tr>
<td>$500.0</td>
<td>Financial Advisor to Public Utility Commission Texas</td>
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<tr>
<td>$789.8</td>
<td>Financial Advisor to Public Utility Commission Texas</td>
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<tr>
<td>N/A</td>
<td>Financial Advisor to Vermont Public Service Board (Purchasing Agent, VEPR Inc.)</td>
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<tr>
<td>N/A</td>
<td>Financial Advisor to Wisconsin Public Service Commission (PSC)</td>
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<tr>
<td>$102.7</td>
<td>Financial Advisor to New Jersey Board of Public Utilities</td>
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<tr>
<td>$1,851.0</td>
<td>Financial Advisor to Public Utility Commission Texas</td>
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<td>$1,739.7</td>
<td>Financial Advisor to Public Utility Commission Texas</td>
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<td>$344.5</td>
<td>Financial Advisor to Public Service Commission of West Virginia</td>
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<td>$114.8</td>
<td>Financial Advisor to Public Service Commission of West Virginia</td>
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<td>$652.0</td>
<td>Financial Advisor to Florida Public Service Commission</td>
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<td>$64.4</td>
<td>Financial Advisor to Public Service Commission of West Virginia</td>
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<td>$215.5</td>
<td>Financial Advisor to Public Service Commission of West Virginia</td>
</tr>
<tr>
<td>$375</td>
<td>Financial Advisor to the Office of the People’s Counsel (i.e., Ratepayer Advocate) of the District of Columbia Public Service Commission</td>
</tr>
<tr>
<td>N/A</td>
<td>Financial Advisor to California Community Choice Association for financial analysis and testimony before the California Public Utilities Commission Rulemaking (CPUC17-06-026 Proceeding)</td>
</tr>
<tr>
<td>N/A</td>
<td>National Regulatory Research Institute (NRRI) Fellow (Joseph S. Fichera) and author of securitization NRRI “Insights” article January, 2019</td>
</tr>
<tr>
<td>N/A</td>
<td>Advisor to HEAL Utah (Healthy Environment Alliance) securitization legislation proposal</td>
</tr>
</tbody>
</table>

$9,020 Billion

Since 1997 Utility Securitization Laws: 24 States + DC + Puerto Rico
Only 9 Active and Can Issue Now, 6 Considering Legislation, 3 New in 2019

Passed laws in 2018-19

States with Legislation
- States Securitization Being Considered
- States Securitization Active Legislation
Total ~$50.9 billion ISSUED, 65 Investor-Owned Utility Transactions* 

- Deregulation – Stranded Costs
- PG&E Bankruptcy Exit – Regulatory Asset Refinancing
- First Use of Securitization for Storm Recovery / Environmental
- Financial Crisis

Total ~$50.9 billion ISSUED, 65 Investor-Owned Utility Transactions* 

- Deregulation – Stranded Costs
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- First Use of Securitization for Storm Recovery / Environmental
- Financial Crisis

Securitization Bond Issues By State 1997 – Present $ Volume + # of Issues

- States with Legislation
- With Legislation Best Practices
- Volume in Each State ($ Millions)
- with # of Bond Issues

**New York reflects taxable debt component only of securitization bond which was permitted solely for Long Island Public Power Authority, a municipal utility. Hawaii is government beneficiary through charge on IOU customers.
Majority Bonds Sold Have Short to Intermediate Maturities 1-10 years…and are Matured/Gone!

Cumulative Issued 1997- Present ~ $50.3 Billion

<table>
<thead>
<tr>
<th>Years</th>
<th>$ Millions</th>
</tr>
</thead>
<tbody>
<tr>
<td>WAL &lt;5</td>
<td>$16,034</td>
</tr>
<tr>
<td>WAL 5-10</td>
<td>$24,477</td>
</tr>
<tr>
<td>WAL 10-15</td>
<td>$9,410</td>
</tr>
<tr>
<td>WAL &gt;15</td>
<td>$1,001</td>
</tr>
</tbody>
</table>

Amount Outstanding in May 2019 Only ~ $5.9 Billion

<table>
<thead>
<tr>
<th>Years</th>
<th>$ Millions</th>
</tr>
</thead>
<tbody>
<tr>
<td>WAL &lt;5</td>
<td>$3,858</td>
</tr>
<tr>
<td>WAL 5-10</td>
<td>$1,212</td>
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<tr>
<td>WAL 10-15</td>
<td>$538</td>
</tr>
<tr>
<td>WAL &gt;15</td>
<td>$275</td>
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</tbody>
</table>

Significant Market Opportunity. Though a Challenge, Great Demand from Investors for Longer > 15-year Maturities

*WAL = Weighted Average Life/Maturity

Eight Primary Uses Over Time and Still Evolving – After Costs Determined Prudent and Recoverable

1. Rate reduction to facilitate deregulation of energy market
2. Recovery of stranded costs resulting from electric industry deregulation
3. Buydown of above market power purchase agreements
4. Deferred balances and regulatory assets
5. Costs of new pollution control equipment
6. Storm recovery costs
7. Costs of new renewable distributed generation
8. Recovery of remaining costs of early retired nuclear plant
In the Past, Used Mostly for Stranded Costs; Not that Many Utilities with Large Issuances

<table>
<thead>
<tr>
<th>Total Utility Securitization Bonds Issued by Use of Proceeds 1997-2018</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Stranded Costs</strong> 39 Deals, $40,217.7</td>
</tr>
<tr>
<td><strong>Storm Recovery</strong> 10 Deals, $3,254.8</td>
</tr>
<tr>
<td><strong>Deferred Balances</strong> 6 Deals, $2,000.9</td>
</tr>
<tr>
<td><strong>Nuclear Plant Retirement</strong> 1 Deal, $1,294.3</td>
</tr>
<tr>
<td><strong>Regulatory Asset</strong> 4 Deals, $3,063.6</td>
</tr>
<tr>
<td><strong>Environmental</strong> 4 Deals, $545.2</td>
</tr>
<tr>
<td><strong>Distributed Generation</strong> 1 Deal, $150.0</td>
</tr>
</tbody>
</table>

Note: Distributed Generation includes State of Hawaii Government Issue based on charge Hawaiian Electric Co., customers a non-IOU deal.

New Uses For Securitization Are Emerging

- Wildfire Costs
- Coal Ash Remediation
- Undergrounding Distribution Systems
- Grid Expansion
- Accelerating Coal to Clean with New Securitization Advocates
  - Sierra Club
  - National Resources Defense Council
  - Western Clean Energy Advocates
  - Rocky Mountain Institute
  - Climate Policy Initiative
- Climate Change Initiatives
## Environmentalists Promoting Securitization to Retire Over 70 Gigawatts (GW) of Uneconomic Coal (UC) in 16 Regulated States AND Provide Transition Costs to Communities

<table>
<thead>
<tr>
<th>States with New Securitization Legislation</th>
<th>States with Pending New Securitization Legislation</th>
</tr>
</thead>
<tbody>
<tr>
<td>NH</td>
<td>4.3 GW UC</td>
</tr>
<tr>
<td>MN</td>
<td>3.1 GW UC</td>
</tr>
<tr>
<td>IA</td>
<td>6.9 GW UC</td>
</tr>
<tr>
<td>WI</td>
<td>9.4 GW UC</td>
</tr>
<tr>
<td>ND</td>
<td>3.8 GW UC</td>
</tr>
<tr>
<td>SD</td>
<td>3.4 GW UC</td>
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<tr>
<td>KS</td>
<td>6.4 GW UC</td>
</tr>
<tr>
<td>MO</td>
<td>4.3 GW UC</td>
</tr>
<tr>
<td>KY</td>
<td>3.3 GW UC</td>
</tr>
<tr>
<td>VA</td>
<td>6.4 GW UC</td>
</tr>
<tr>
<td>NC</td>
<td>3.0 GW UC</td>
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<tr>
<td>FL</td>
<td>1.4 GW UC</td>
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<tr>
<td>TX</td>
<td>4.8 GW UC</td>
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<td>IN</td>
<td>6.9 GW UC</td>
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<tr>
<td>MO</td>
<td>4.8 GW UC</td>
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<tr>
<td>IL</td>
<td>5.6 GW UC</td>
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<tr>
<td>IA</td>
<td>4.6 GW UC</td>
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<tr>
<td>KS</td>
<td>4.4 GW UC</td>
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<td>3.4 GW UC</td>
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<tr>
<td>WI</td>
<td>4.3 GW UC</td>
</tr>
<tr>
<td>MN</td>
<td>1.4 GW UC</td>
</tr>
<tr>
<td>WA</td>
<td>0.6 GW UC</td>
</tr>
</tbody>
</table>

Securitization Has Resulted in Much **Lower Revenue Requirements** and **Large Savings in Today’s Dollars (NPV) for Ratepayers**

### Duke Energy Florida (FL) 2016
- $1.294 billion in unrecovered depreciation of a closed/early retired nuclear plant.
- $680 million NPV Savings

### Consumers Energy (MI) 2014
- $389.6 million unrecovered depreciation of 950 MW of coal-fired capacity retired 2016.
- $135 million NPV Savings

### Allegheny Energy (Monongahela & Potomac Edison) (WV) 2007,09
- $543 million in pollution control equipment and upgrades.
- $130 million NPV Savings
5 Components of Ratepayer Savings: Securitized “Debt for Equity”
Reductions in REVENUE REQUIREMENTS Lead to Large NPV Customer Savings

1. Issue Stand-Alone, Non-Recourse Debt to Replace Shareholder Equity 55-57% of NPV savings
2. Eliminate Paying Utility’s Federal/State Income Taxes on Revenues Received for Costs of Shareholder Equity Capital 30-33% of NPV savings
3. Levelize Securitization Bonds’ Principal & Interest Payments vs. Traditional Declining Balance of Utility Debt & Equity at WACC 8-9% of NPV savings
4. Pay Lower Interest Rates Due to AAA Bond Rating vs. Utility’s Lower Rating (A3/ Baa1) 1-2% of NPV savings
5. Eliminate Other “Revenue Related” Fees <1% of NPV savings

WACC = Weighted Average Cost of Capital

Sources of Utility Securitization Ratepayer NPV Savings

Traditional Utility Financing: (50% Debt + 50% Equity) Needs This Much Revenue From Electricity Sales Each Year for Declining Balance Amortization 25-Year Asset

Lower Revenue Requirements Over 25 years 9%
No Income Taxes On Required Revenues 33%
Eliminate Utility Equity Costs 55%
Lower Revenue Based Fees 1%
Lower Interest Expense 2%

(*) Savings net of issuance costs. 15-Year Weighted Average Life of Bond
4 Phases of Utility Securitization

Pass Special State Authorizing Legislation
- Address Rating Agency Issues
- Standards for Ratepayer Protections
- Commission Authority – Permissive or Restrictive

Utility Submits Financing Order Application for Prudent and Recoverable Costs
- Testimony from Utility and Commission
- Transparency

Write/Approve Detailed Financing Order
- Utility’s Draft vs. Commission’s
- Estimates vs Actual Costs
- Ratepayer Protections

Implement Financing Order
- Structuring of Bonds
- Marketing
- Pricing

Key Elements Needed for Special State Law to Authorize Securitization to Achieve Stand-Alone Credit and Top Credit Rating

1. Create “Intangible Property Right” to a “Non-Bypassable Charge” on All Ratepayers on Joint Basis – Right to Bill, Charge, Collect and Adjust

2. Allow “True Sale” of the Property Right (transfer) to Ring Fenced/Bankruptcy Remote Entity


4. Require Automatic Ongoing Commission True Up/True Down Adjustment of Non-Bypassable Charge – No Cap!

5. Require State Pledge of Non-Interference with Bondholder Rights to Property/Charge
What’s the Difference Between Traditional Utility Bonds and Securitization Bonds?

1) It is State Specific. Not “Cookie Cutter” Approach.

2) No Standard Documentation. State/Utility Specific

3) Issuance has been Sporadic and Amortizing Run Off of Bonds Shrinks Amount or Product in the Market Over Time.

4) Little Institutional Memory in Market

5) Market Turnover in Personnel (Investors, Bankers etc.) since 2008-09 Financial Crisis; Many Competing Investments for Yield vs Safety.

Is Utility Securitization Now a “Commodity” Product? All the Same?
**Traditional Utility Bond - Simple**

1. **Public Utility Commission**
   - Ongoing oversight through rate cases.

2. **Electric Service Customers**
   - Utility responsible for all costs. Utility seeks recovery through rate cases.

3. **Utility**
   - Bonds

4. **Trustee**
   - Semi-Annual Principal & Interest Payments

5. **Investors**
   - Bondholders have direct claim on Utility.

**SECURITIZATION Bond: VERY Complex Transaction**

1. **Legislature**
   - Monthly Electric Service Bill Payments
   - Utility establishes a newly formed Ring-Fenced/Bankruptcy-Remote Finance/Issuer Company

2. **Public Utility Commission**
   - Sale of Property for Cash Payment
   - Irrevocable Financing Order; No further review

3. **Securitization Finance Issuer**
   - Pledge of Property

4. **Utility**
   - Cash Payment from Bond Proceeds (From Sale of Bonds to Investors)
   - Non-Bypassable Charges (as Trued-up) Added to Monthly Electric Bill
   - Utility collects and remits Non-Bypassable Charges

5. **Trustee**
   - Semi-Annual Principal & Interest Payments

6. **Investors**
   - Bond Proceeds (Cash received from Investors)
   - Investors have no recourse to Utility only to Special Property Right (non-bypassable charges). Ratepayers are responsible for all costs directly and jointly.
Irrevocable Financing Order is Just the Beginning

Selected Transaction Documents

- Sale Agreement & Bill of Sale
- Service Agreement
- Intercreditor Agreement
- Administration Agreement
- Underwriting Agreement

Start Here: Financing Order

Establish New Financing Subsidiary

Registration Statement & Amendments (including Prospectus and Supplement)

Corporate or ABS Structure

Indenture

Multiple Federal and State Legal Opinions
Who are Principal Investors in Utility Securitization Bonds?

Money Managers  Corporations  Pension Funds  Insurance Companies

The KEY Issue for Regulators

A Fiduciary Duty to Ratepayers:
Who will represent customers/ratepayers in the structuring, marketing and pricing of the securitization bonds since the utility is not responsible for any costs??

In securitization, every dollar is a ratepayer dollar.
In traditional utility bond offerings, the negotiating parties have competing/conflicting economic interests.

Competing economic interests are balanced and checked in the negotiation to lead to an “efficient” and fair pricing result.

Regulators have full cost of capital ongoing review in rate cases.

Parties to a Traditional Utility Bond Offering Negotiation in Structuring, Marketing & Pricing

- Utility/Iissuers
- Investors
- Underwriters
- Commission
In a Traditional Utility Bond Offering Process, Each Party Acts in Its Own Economic Interest and Competing Interests Are Balanced and Checked.

**Utility/Issuer**
(when responsible for costs) seek lowest bond rates – can maximize allowed return by minimizing expenses between rate cases.

**Investors**
Seek highest return/rates for lending their capital in relation to bond’s credit risk (rating) and other factors.

**Underwriters**
(middle person between issuer and investors) seek highest rates for the quickest sale while maintaining relationship with Utility/Issuer for future business.

**Commission**
Retains full ongoing regulatory review over Utility’s cost of capital – “Rate Cases.”

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What is Different in Utility Securitization Bond Offering?

In Utility Securitization, Economic and Competing Interests of Parties Are Not Balanced, Not Checked:

**Utility/Issuer**
While still concerned about customers, Utility is not responsible for any bond costs – economic interest is to get the bond proceeds (money) as soon as possible.

**Ratepayers responsible for ALL costs!**

**Investors**
Seek highest return/rates for lending their capital even at top quality AAA rate – not all AAA bonds are priced alike.

**Underwriters**
(middle person between issuer and investors) continue to seek highest rates for quickest sale while maintaining relationship with Utility for future business.

**Commission**
Must forego all POST ISSUANCE regulatory review over charge on bonds. Not permitted to adjust any other utility rates.
What is a Fiduciary Duty to Ratepayers in Utility Securitization?

A Relationship of Trust and a Requirement to Act in Best Interests of the Client and Not One’s Own Economic Interests.

1. Provide advice that is in the client’s best interest;
2. Seek best execution;
3. Act and provide advice and monitoring over the course of the relationship.

So, Leave It to the Underwriters?
Underwriters Have No Fiduciary Duty to Ratepayers nor to Utility nor to Commission

Excerpt from Actual Securitization Bond “Underwriting Agreement” Underwriters Require of an Issuer

Section Entitled: “Absence of Fiduciary Relationship”

1. [The utility] acknowledges and agrees that the Underwriters are acting solely in the capacity of an arm’s length contractual counterparty to the [utility] with respect to the offering of the Bonds ... (including in connection with determining the terms of the offering) and not as a financial advisor or a fiduciary to, or an agent of, (the utility) ...

2. [The utility will] consult with their own advisors concerning such matters and shall be responsible for making their own independent investigation and appraisal of the transactions contemplated, and the Underwriters shall have no responsibility or liability to (the utility) with respect thereto.

3. Any review by the Underwriters ... of the structure and terms of the transactions ... will be performed solely for the benefit of the Underwriters and shall not be on behalf of [the utility] . . . .”*
So, Leave It to the Underwriters?
Regulators should believe bankers when they say...

“The primary role of Goldman Sachs, as an underwriter, is to purchase securities, for resale to investors, in an arm’s-length commercial transaction between the Issuer and Goldman Sachs will act in its own interest and has financial and other interests that differ from those of the Issuer.” ¹

¹ See Public Service of New Hampshire d/b/a Eversource Energy Docket No. DE 17-096 Securitization Petition Attachment RR 1-013 Page 2

In Utility Securitization, Conflicting Economic Interests Are Not Balanced or Checked and Create Hurdles to Lowest Cost Financing for Ratepayers

Underwriter Objectives vs. Ratepayer Interests – Need for Checks and Balances.

Underwriters “Price it to sell quickly, move on”

Little investor education on the unique securitization credit, true-up, charge on essential commodity

Investor and underwriter misperceptions of utility securitization credit and liquidity

- Mispricing of bond credit and “relative value” to other investments
- Higher cost to ratepayers.
Differences with Traditional Utility Bond Offerings – Pluses + and Minuses -

**TRADITIONAL OFFERING**

+ Familiar Credit but Lower Credit Quality
+ Frequent Issuance
  + Across yield curve
+ Broad Participation
  + $250 Million Deal
  + Typically 200 Investors
+ Bonds Trade Frequently in Secondary Market

**SECURITIZATION OFFERING**

- New Credit & AAA Credit Quality
- **Sporadic Issuance** Market Wide
- One-off/Unique for the Utility
- Narrow Distribution
  - $1 Billion Deal
  - Typically 20-30 Investors
- Not Much Trading in Secondary Market

Identifying Best Practices for Ratepayers
6. A 120-day post-issuance Commission review and audit of financing costs.

5. Commission Resources:
   - No artificial or arbitrary limits placed on the scope of the financial advisor’s or legal counsel’s activities or their fees, so long as they are agreed to by the Commission.
   - Payment of fees of the Commission experts, including any financial advisor and legal counsel, should be a transaction cost identical to treatment of utility advisors, counsel and underwriters.

4. The Commission needs access to expert resources with a duty of loyalty solely to the Commission to complement staff e.g., financial advisor and outside legal counsel to protect ratepayers’ interests and support a fiduciary duty to ratepayers.

3. Utility should certify with confirmation by the Commission after pricing but before closing that the lowest cost standard in fact has been achieved so that the Commission could stop the transaction if standard not achieved, as allowed in other states.

2. A clear and meaningful “lowest cost to ratepayers” standard under market conditions at the time of pricing established.

1. Commission authority to include additional terms and conditions in the financing order for the benefit of ratepayers and to protect the public interest in structuring, marketing and pricing.
Active Commission Oversight with Utility Cooperation Have Produced Better Market Results

Judging Success in Capital Markets - Focus on Credit Spread

Treasury Bond ("Risk Free") – A Benchmark
Also can be LIBOR/Swap equivalent to a Bank rate like the Prime rate

1 Basis point = 1/100 of 1%
Wide variances in total interest costs to ratepayers.

Wide variances in transaction costs and utility efforts to achieve “lowest cost” versus only “lower costs.”

Credit spreads vary dramatically.
- U.S. Agencies + Sovereigns
- Mortgage-Backed Securities
- Pure Corporates + Utilities

Not all AAA’s price alike. Debate with underwriters over “relative value” of competing investments with higher yield/costs affects ratepayers long-term.

Recent Examples of Different AAA Interest Rates in Market
All AAA rated securities do not price alike, as evidenced by pricing variations across various long-dated AAA rated corporate, agency, asset backed securities (ABS) / collateralized mortgage backed securities (CMBS), and municipal bonds shown below.

Secondary Trading Spreads – 10-Year AAA Comparables MARCH 29, 2019

Source: Bloomberg; TRACE. Includes trades of $1 million or more. (1) Represents new-issue transaction and associated pricing.

Best Practice Examples
The 1999 Texas Public Utilities Regulatory Act (PURA) Mandate –
Began the “Active Commission Involvement” Practice - A Best Practice

“The commission shall ensure that securitization provides tangible and quantifiable benefits to ratepayers, greater than would have been achieved absent the issuance of transition bonds.”

“The commission shall ensure that the structuring and pricing of the transition bonds result in the lowest transition bond charges consistent with market conditions and the terms of the financing order.”

See https://statutes.capitol.texas.gov/Docs/UT/htm/UT.39.htm

Prior to the first Texas securitization bond sale in 2001, $21 billion utility securitization bonds were sold with no active Commission involvement. Beginning in 2001 Texas Commission took active role.

Citi’s analysis, sent to Texas’s financial advisor Saber Partners (email left) showed $23 million+ savings to Texas customers from the active PUC Texas oversight with their advisors on Texas’s first three securitization offerings.

Example: Citigroup and Other Studies*
Confirmed Savings From Active Commission Oversight – First 3 Texas Deals 2001-2003

To summarize, the difference in total savings vs other transition bonds
1. Reliant: $3,773,775 or 6.5 bps/yr (nominal), $2,955,295 or 5.1 bps/yr (PV)
2. CPL: $12,951,663 or 20.3 bps/yr (nominal), $9,748,976 or 15.3 bps/yr (PV)
3. Oncor: $6,629,694 or 19.4 bps/yr (nominal), $5,278,669 or 15.4 bps/yr (PV)
Total: $23,355,132 (nominal), 17,982,941 (PV)"

See State of Wisconsin Public Service Commission at
Best Practice Example: **Active** Commission Ratepayer Savings 2001-2005

![Graph](image)

Note: (1) Excludes WALs less than 2 years since they were priced off of a different benchmark. Sources: Bloomberg and SEC Prospectuses

Basis points (bps) = .01%

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**2016 Florida Public Service Commission Actions**

- Established **Lowest Cost Objective in Financing Order**.
- Created **Bond Team – Commission and Utility**.
- Sold $500+ million LONG Duration 15-20 years.
- Largest offering with longest maturity of its kind to date.
- Offering was in untested long-term (>15 years) market.
- Long maturities are most expensive to ratepayers.

**Best Practice Example: Florida (Duke Energy Florida (DEF)) Ratepayer Savings From an **Active** Commission Vs. Other States 2010-2016**

![Graph](image)

**2010-2016 Investor-Owned Utility Securitization Spread To Interpolated AAA US Agencies Curve**

- **Entergy New Orleans Storm Recovery**
- **All Other States**
- **Florida**

Basis points (bps) = .01%
Best Practice Example: Florida (Duke Energy Florida (DEF)) Ratepayer Savings From an **Active** Commission Vs. Other States 2010-2016

Utility Securitization Needs Transparency, Oversight, Cooperation, Collaboration “Checks and Balances”
Besides Lowest Cost Pricing, Emerging Utility Securitization Issues

Should securitization debt be a permanent part of a utility’s ongoing capital structure or “one-off”? If permanent, create smaller balance sheet? Create safer credit?

How much securitization is too much?

Always used voluntarily, at option of utility or can it be mandated?

Example of Law That Can Require Utility to Use Securitization: Texas Storm Securitization Legislation

TEXAS: Public Utilities Regulation Act (PURA) Section 36.403(b):

"Subject to the standards, procedures, and tests contained in this subchapter and Subchapter G, Chapter 39, the commission shall adopt a financing order on the application of the electric utility to recover its system restoration costs. If on its own motion or complaint by an affected person, the commission determines that it is likely that securitization of system restoration costs would meet the tests contained in Section 36.401(b), the commission shall require the utility to file an application for a financing order."
Example of Law That Can Require Utility to Use Securitization: Texas Storm Securitization Legislation

- It is the intent of the legislature that:
  1. “securitization of system restoration costs will be accomplished using the same procedures, standards, and protections for securitization authorized under Subchapter G, Chapter 39, as in effect on the effective date of this section, except as provided by this subchapter; and
  2. the commission will ensure that securitization of system restoration costs provides greater tangible and quantifiable benefits to ratepayers than would have been achieved without the issuance of transition bonds.”

- The previous (1999) legislation Subchapter G, Chapter 39, referred to in the above excerpt from the storm recovery legislation has this protection/standard:
  “The commission shall ensure that the structuring and pricing of the transition bonds result in the lowest transition bond charges consistent with market conditions and the terms of the financing order.”

Thank you for the privilege of your time.
How Are Utility Securitization Bonds Different From Traditional Utility Bonds?  
A Summary for Commission Oversight, Utility Cooperation and Collaboration

- The bonds being issued for the recovery of the specified costs are very different from typical bonds issued by a utility. In utility securitization, also known as ratepayer-backed bonds, regulators are asked to use their regulatory authority in a way that has either never or rarely been done.

- The commission is asked to forego future regulatory oversight over the costs and charges to create a financing instrument – a ratepayer-backed bond – of superior quality and a completely separate (i.e., independent) credit from the sponsoring utility. The irrevocable nature of the financing order, the direct broad-based non-bypassable charge applied to all utility ratepayers, the unconditional commission guarantee to adjust the charge as necessary, and the explicit pledge of the State not to interfere with the bondholders’ rights to repayment result in an incredibly strong credit independent of the sponsoring utility.

- In typical utility debt offerings, the utility has a strong incentive to negotiate hard with underwriters and investors for the lowest possible interest rates as well as the lowest possible fees. The utility also has a strong incentive to minimize other issuance costs. Between rate cases, the benefit of a low net cost of funds is enjoyed at least in part by the utility’s shareholders and the detriment from a high net cost of funds is borne at least in part by these same shareholders.

- These same checks and balances do not exist for the issuance of ratepayer-backed bonds. While typical utility bonds directly affect a utility’s financial statements, ratepayer-backed bonds are not direct obligations of the sponsoring utility and are non-recourse to the utility. Utility securitization will not be recognized in the sponsoring utility’s debt coverage or other financial ratios for credit rating purposes. For these reasons, the same incentives and consequences for pursuing a lowest cost of funds with regard to typical utility bonds are not present with respect to the issuance of ratepayer-backed bonds.

- In fact, the sponsoring utility will receive the same amount of money from the issuance of ratepayer-backed bonds regardless of the level of the interest rates or issuance costs, high or low. Unless the sponsoring utility is committed to pursuing a lowest cost transaction by accurately communicating the unique and high-quality characteristics of the proposed ratepayer-backed bonds with the commission, the bonds will not trade at the credit spreads representative of the value and safety of these bonds.
How Are Utility Securitization Bonds Different From Traditional Utility Bonds?
A Summary for Commission Oversight, Utility Cooperation and Collaboration

- While utility securitization can provide significant cost savings over traditional forms of recovery, these savings are not automatic. Ratepayers must be effectively represented throughout the proposed transaction.

- The regulator’s active involvement in the structuring, marketing, and pricing of ratepayer-backed bonds is key to protecting ratepayer interests and will determine the transparency of the transaction and customer support. In particular, the commission with its financial advisor needs to be an active and visible participant in the pricing process in real time if the commission is to obtain maximum benefits for ratepayers.

- Only through active cooperation and collaboration with the commission, can the sponsoring utility, and other principal transaction participants be held accountable. That is, did, the actual structuring, marketing, and pricing of the ratepayer-backed bonds in fact result in the lowest recovery charges consistent with then-prevailing market conditions and the terms of the financing order?