Before the Senate Public Utilities Committee

Interested Party Testimony Regarding Senate Bill 248
Presented by:
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Good morning Chairman Daniels, Vice Chair Balderson, Ranking Member Schiavoni, and members of the Senate Public Utilities Committee. I am Bruce Weston, the Interim Consumers' Counsel for the Office of the Ohio Consumers' Counsel (OCC). Thank you for allowing me to appear before you today to discuss the as-introduced version of Senate Bill 248 (SB 248) and the impact that the bill would have on Ohio's residential utility customers. As you know, OCC is the statutory representative of Ohio's residential utility consumers, and regularly appears before the Public Utilities Commission (PUCO or Commission) on their behalf.

OCC supports the concept of securitization, which can provide significant benefits to Ohio's utility customers. However, there are a few crucial improvements that are needed in the bill for customers to receive the full benefit of securitization.

The following recommendations will help Ohio customers save the most money and receive the most benefit from securitization:

1. A **Least Cost Standard** Should be Adopted to Protect Customers;
2. There Should be A Transparent Process for Reviewing Securitization Requests that Includes A **Public Hearing** and the Advice of an **Independent Financial Advisor**;

3. **Technical Amendments** Should be Adopted to Clarify Components of the Legislation and Conform the Legislation to Procedures Set Out in Existing Law.

Recommendations

1. **A Least Cost Standard Should be Adopted to Protect Customers.**

Securitization can be a valuable financing tool to reduce the overall interest rate utility customers pay for various utility costs. The inclusion of a least-cost standard is needed to help customers achieve the best outcome through securitization. The proposed bill, as introduced, states that "cost savings to customers" must be "reasonably expected" (lines 387-394):

> [T]he commission shall issue a financing order . . . if the commission finds that the issuance of the phase-in-recovery bonds and the phase-in-recovery charges authorized by the order are both reasonably expected to result in cost savings to customers and reasonably expected to mitigate rate impacts to customers as compared with traditional financing mechanisms or traditional cost-recovery methods available to the electric distribution utility.

This language, that savings merely be "reasonably expected," leaves the benefits of securitization too uncertain and should be amended. Also, the requirement for "cost savings" should be strengthened to give customers more than just some cost savings, by requiring securitization at the least cost to customers.

Some states have included a least-cost standard in their securitization legislation. These states include Florida, Michigan, New Jersey, Texas, and Wisconsin. For example, the Texas enabling statute explicitly states that "[t]he commission shall ensure that the structuring and pricing of the transition bonds result in the **lowest bond charges** consistent with market conditions and the terms of the financing order."[1] Similarly, the New Jersey enabling statute specifies that the New Jersey Board may only issue a financing order if "[t]he structuring and pricing of the bonds

[1]Tex. Util. Code § 39.301, emphasis added.

assure that the electric public utility's customers pay the **lowest transition bond charges** consistent with market conditions…"[2]

The Florida statute's least cost standard:

> Within 120 days after the issuance of storm-recovery bonds, the electric utility shall file with the commission information on the actual costs of the storm-recovery bond issuance. The commission shall review such information to determine if such costs incurred in the issuance of the bonds **resulted in the lowest overall costs** that were reasonably consistent with market conditions at the time of the issuance and the terms of the financing order. The commission may disallow any incremental issuance costs in excess of the lowest overall costs by requiring the utility to make a contribution to the storm reserve in an amount equal to the excess of actual issuance costs incurred, and paid for out of storm-recovery bond proceeds, and the lowest overall issuance costs as determined by the commission.[3]

Throughout the securitization process, there are various areas where costs to customers can either be added or be reduced. For instance, the cost of issuing the bonds may include: underwriters' fees, rating agency fees, legal fees, accounting and auditing fees, trustee and trustee counsel fees, stock exchange listing fees and compliance fees, filing fees, any applicable taxes, printing and marketing expenses, company's financial advisor's fee, and other miscellaneous charges. Additionally, there is room for flexibility in the actual pricing of the bonds. Without a least cost standard, there is no guarantee that these costs will be kept to a minimum for customers.

I have included suggested amendment language for the least cost standard in Attachment 1 – Amendment 1 in this testimony.

[2] N.J. Rev. Stat. § 48:3-62(14)(b)(4), emphasis added
[3] F.S. 366.8260(2)(b)(5)]:

2. There Should be a Transparent Process for Reviewing Securitization Requests that Includes the Advice of an Independent Financial Advisor and a Public Hearing.

a. An Independent Financial Advisor Should be Engaged for the Securitization Process, to Minimize the Costs that Customers Will Pay.

Securitization is a specialized area for structuring and issuing bonds related to phase-in costs. The process at the PUCO would benefit from the participation of an independent financial advisor before there is approval of these transactions. This independent advisor should assist the PUCO, the utility company, and other parties in achieving the least cost for customers throughout the process. That advisor should be someone who is experienced and independent, i.e. someone not involved in the buying, selling or trading of the bonds under consideration.

There are two key steps in the securitization process that would benefit from an independent financial advisor. The first step in the process is the development of the financing order. Under the proposed legislation, this is the 135-day process where the PUCO and others have the opportunity to review the utility's request for securitization. Having an independent financial advisor's advice during this first step would provide an expert's opinion that is separate from that of the utility on matters that affect customer's utility bills.

The second step of the process is after the financing order has been issued. The utility at this step engages the financial community in an effort to sell the phase-in recovery bonds. At this point the utility (and not other stakeholders) is primarily involved in the process. The final issuance of the phase-in recovery bonds would benefit from the active involvement of an independent financial advisor that is given the responsibility to ensure the issuance of the bonds results in the least cost to customers.

Results in other states have shown the importance of an independent advisor for the securitization review and issuance process. For example, in Wisconsin the staff of the Public Service Commission investigated results from securitization proceedings and concluded that "statistical analysis of actual securitization data suggests that for a 10-year securitization issue, [the expert financial advisor's] advice would reduce the yield spread on the security by about "15 to 20 basis points" that would amount to "$750,000 to $1,000,000 per year" on a "$500 million security" offering.[4]

The Public Service Commission of West Virginia approved an agreement by parties for securitization that stated "the Commission's Financial Advisor . . . was helpful in achieving the Lowest Cost Objective and in ensuring that customers' interests were protected . . ." [5]

In Florida, staff at their Public Service Commission estimate that their financial advisor helped save customers between $6 - $8 million in their 2006 securitization deal[6].

In Texas, where the regulatory commission has used securitization, an affiliate of American Electric Power supported the use of an independent financial advisor. Central Power and Light stated in a filing before the Public Utility Commission of Texas that:

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[4]Analysis of Potential Savings, Steven G. Kihm, Wisconsin PSC Gas and Energy Division, Executive Summary. The Analysis, performed in 2005, also reports that it "confirms the strong recommendation received from the staffs of the New Jersey Board of Public Utilities [and] the Public Utility Commission of Texas that . . . [expert] advice adds substantial value for the ratepayer." It appears that the utility in this case did not proceed with the final issuance of the bonds.

[5] Financing Proceeding, W.V. PSC Case No. 05-402-E-CN, Order at 8 (September 30, 2009).

[6] This analysis was provided in an email to the OCC that is available upon request.

> "Underwriters clearly will provide 'advice' that is useful to the Applicant and the Commission in structuring an pricing the bonds, much in the same way that buyers and sellers rely upon information from each other in any complex transaction. As providers of financial advice, underwriters may be considered financial advisors but they are not performing the duties of a Financial Advisor who has only the interest of the issuer within its responsibility. In the process of evaluating the information, and deciding whether the pricing and structure of the bonds provides intended benefits for ratepayers, the Applicant and Commission should rely on their own expertise and that of a Financial Advisor who does not have an interest in attempting to market the bonds and receive compensation from that activity.")[7]

These examples reflect that substantial savings to customers can be realized if an independent financial advisor is involved throughout the process.

The practice of hiring an independent expert has been used in a number of cases at the PUCO over the years. For example, the PUCO has hired independent auditors to conduct audits of large expenses such as fuel in cases that involve both electric and natural gas utilities. OCC supports the use of consultants in these highly technical areas that involve hundreds of millions of customers' dollars. Attachment 1 – Amendment 2 contains suggested language for this proposal.

b. The Process for Reviewing Securitization Requests Should Be Transparent and Include a Public Hearing.

As introduced, SB 248 requires the PUCO to "publish a schedule of the proceeding" [line 368] and the proceeding would be "governed by Chapter 4903 of the Revised Code" [lines 360-361]. Those provisions do not require the PUCO to hold a hearing to receive information about the securitization proposal.

[7] Central Power and Light, Texas PUC Docket No. 21528, CPL Supplemental Comments at 2 (February 17, 2000. The affiliation between Central Power and Light and American Electric Power's utilities in Ohio came about as the result of a merger that was announced on December 22, 1997 that was completed on June 15, 2000.

Under the bill, the utility would provide a significant amount of information to the PUCO in an application that could result in a range of costs or cost savings for customers. Specifically, the legislation requires the utility's application to include information regarding the uncollected phase-in costs; an estimate of the date of bond issuance; the expected term for the collection of the phase-in costs; an estimate of the financing costs; an estimate of phase-in recovery charges and financing costs; a proposal for allocating phase-in charges among customer classes; an adjustment mechanism for the appropriate collection of charges from customers; a statement of how the securitization will provide cost savings to customers; and possibly other information required by the Commission [lines 319-352]. Such an application would begin the process by which the PUCO would approve, modify, or reject the utility's application in the PUCO "financing order" [See, e.g., line 371].

The utility's application provides substantial information regarding the costs that customers will be asked to pay through a non-bypassable charge that may result from the securitization. While a hearing is not generally required for the approval of utility applications for financing, the applications contemplated in the bill are unique in that they involve the direct determination of customer rates. This type of case usually requires a hearing under Title 49 of the Revised Code. Customer parties should have the opportunity to present evidence for the PUCO's consideration in making its decisions on securitization requests.

Several other states require hearings as a part of the securitization process. Specifically, Idaho, Illinois, Montana, New Hampshire, New Jersey, Pennsylvania, West Virginia, and Wisconsin require hearings. Attachment 1 – Amendment 2 contains suggested language for this proposal.

3. Technical Amendments Should be Adopted to Clarify Components of the Legislation and Conform the Legislation to Existing Law.

There are some uses of language in SB 248 that may lead to unintended results in the interpretation of the statute. Specifically, there is an inconsistency within the proposed legislation regarding parties that have standing in securitization cases. All parties that participated in cases that authorized costs eligible for securitization -- as those cases are identified by the statutes under which they arose [lines 275-281] -- should also be provided standing in the cases that determine the financing orders for the securitization [line 362-365]. The as-introduced version of SB 248 contains wording that limits customer parties from representing their interests in securitization proceedings [lines 362-365].

In addition, the legislation suggests that the PUCO has already determined that all of the phase-in costs are reasonable and can be collected from customers [lines 275 – 281]. This may not be the case. The PUCO often issues an initial accounting authorization for utilities to defer costs. But, the PUCO may later determine – sometimes much later – whether the costs are reasonable and can be collected from customers. Securitization should not be permitted while the final reasonableness of these costs is undetermined. If it is intended for the PUCO to determine the reasonableness of the underlying costs to be securitized during the 135-day period, than the requirement for a hearing would be all the more important. Determining whether these costs, which may be substantial, are reasonable and lawful for collecting from customers is a ratemaking process that typically would be conducted in a hearing.

Lastly, the wording of the proposed legislation should be made consistent with other sections of the Ohio Revised Code that address the regulation of utilities and appeals of Commission decisions to the Supreme Court of Ohio. Attachment 1 – Amendment 3 contains language that would resolve these technical amendments.

Conclusion

In conclusion, securitization can be a useful tool for saving money for Ohio utility customers. I am recommending a few ways this committee can amend the legislation to help customers save more money without negatively affecting the securitization process and outcome. Those ways to benefit customers include a least cost standard, an independent financial advisor, a hearing requirement, and technical clarifications. If these consumer protection amendments were added to the as-introduced version of SB 248, then OCC could support the legislation. Again, thank you for this opportunity to testify.

ATTACHMENT #1

Customer Protection Amendments

NOTE: Suggested amendments are highlighted in gray. There are other sections of the legislation in addition to those listed below that would require conforming changes to be consistent with the primary amendments listed below.

1. **A Least Cost Standard Should be Adopted to Protect Customers.**

   Line 386: "(2) Except as provided in division (D)(1) of this section, the commission shall issue a financing order under division (C) of this section if the commission finds that the issuance of the phase-in-recovery bonds and the phase-in-recovery charges proposed to be authorized by the financing order are both reasonably expected to result in cost savings to customers and ~~reasonably expected to mitigate rate impacts to customers as compared with traditional financing mechanisms or traditional cost-recovery methods available to the electric distribution utility~~ shall provide tangible and quantifiable benefits to residential, commercial, industrial, and other customers greater than would be achieved absent the issuance of phase-in recovery bonds.

   (3) The commission shall ensure that the structuring and pricing of the phase-in-recovery bonds and phase-in-recovery charges result in the lowest charges to the electric distribution utility's residential, commercial, industrial, and other customers consistent with market conditions."

   Line 421: "The commission ~~shall~~ may, in a financing order, afford the electric distribution utility flexibility in order to achieve the lowest cost to customers while establishing the terms and conditions for the phase-in-recovery bonds to accommodate changes in the market conditions, including repayment schedules, interest rates, financing costs, collateral requirements, required debt service and other reserves, and the ability of the electric distribution utility, at its option, to effect a series of issuances of phase-in-recovery bonds and correlated assignments, sales, pledges, or other transfers of phase-in-recovery property."

2. **A Hearing Should be Required that Involves an Independent Financial Advisor.**

   Line 368: "which shall include a hearing. The electric utility shall bear the burden of proof at such hearing."

   The objective of serving customers at the lowest cost can be supported by adding the following language, to obtain the opinion of an independent financial advisor, to line 442:

   The commission shall receive and consider an opinion by an independent financial advisor, one that is not involved in buying or selling or trading the phase-in-recovery bonds under consideration, to determine that the phase-in-recovery charges meet the requirements under division (D)(3) of this section before the electric distribution utility issues the phase-in-recovery bonds. The electric distribution utility cannot proceed with

the issuance of the bonds unless the commission publicly files its final authorization upon consideration of the opinion of the independent financial advisor.

3. **Technical Amendments Should be Adopted.**

To ensure OCC and other customer parties have standing in the securitization cases:
Line 362: "Any party that participated in the proceeding in which phase-in costs were approved under section 4909.18, 4928.143, 4928.144 of the Revised Code or section 4928.14 of the Revised Code as it existed prior to July 31, 2008, shall have standing to participate in proceedings under sections 4928.23 to 4928.2318 of the Revised Code."

Customers should be protected by clarifying that there should be a PUCO ruling on whether the underlying costs for securitization are reasonable and lawful (not just a simple accounting authorization) before the securitization proceeding can begin.
Line 280: "pursuant to a final order by the commission in which dollar amounts have been determined to be reasonable and lawful for collection from customers and for which appeals have been exhausted."

Section 4928.222:

- Remove "petition" and replace with "apply to" or "application."
- Remove "petition for review" and replace with "notice of appeal."
- Remove "petition for rehearing" and replace with "application for a rehearing." Remove "approve" and replace with "affirm."
- Remove the creation of what might be considered a new appeals process suggested by the requirement that a petition for review be "serviced upon the chairperson of the commission personally or by service at the commission's office" and replace with the current, standard appeal process "as provided by section 4903.13 of the revised code."