

Public Utilities Commission of Ohio
Todd A. Snitchler, Chairman

Senate Bill 248 (Balderson)
Senate Energy & Public Utilities Committee

December 13, 2011

Chairman Daniels and members of the Senate Energy & Public Utilities Committee, I am Todd Snitchler, chairman of the Public Utilities Commission of Ohio (PUCO). Thank you for allowing me to be here to today to provide testimony on Senate Bill 248.

If enacted, SB 248 would give the Public Utilities Commission the ability to save electric utility customers money on their electric bills through securitization. In essence, securitization is exchanging short-term, high-interest debt for long-term, low-interest bonds. It is, in effect, refinancing an old higher interest debt with new lower cost debt. Think of it as paying off a higher interest credit card with a lower interest credit card and the savings that consumers achieve on a personal level. Under SB 248, in order to recover the deferred costs through securitization, a utility must apply to the Commission for approval and complete an entire case proceeding. Only after completing the entire case can an electric distribution utility (EDU, in Ohio, AEP, FirstEnergy, Duke, and AES/DP&L) use securitization.

In order to make an application, an EDU is required to have deferred assets, approved by a Commission Order in a prior and separate proceeding in which the Commission ruled that the electric utilities were entitled to those costs and thus authorized to recover them. The deferral of the charges grants a utility the right to collect payment at a later date in time so as to avoid “rate shock” for ratepayers.

As a hypothetical illustration, the Commission could order an investor owned utility to defer their fuel costs because of a dramatic increase in the cost of fuel which would be passed on to ratepayers immediately causing a spike in utility costs for ratepayers. Passage of SB 248 by the Legislature can afford electric utilities and the Commission the opportunity to greatly reduce the cost impact that deferred debts have on ratepayers, and ultimately save the ratepayers money by reducing the costs of carrying deferred charges and doing so at a lower interest rate.

Before I get into the heart of my testimony I would like to mention that we have worked closely throughout this process with the bill sponsor, committee chairman and members, and all interested parties. We have made every effort to listen to and consider their

positions and opinions on a variety of concerns from government aggregation and competition issues, to the legislation's approach of how it treats different market structures and customer classes. We have been ready and willing to share our thoughts on certain provisions within the bill while at the same time mindful of the perspectives of others. As a result of the numerous discussions we have had regarding this bill over the past eight months, I am confident that we have a much stronger piece of legislation that the Commission can use to help save ratepayers a significant amount.

In a more technical sense, SB 248 allows EDUs to reduce the interest charges paid on debt by allowing them to group or securitize their debt through bonds so that they can obtain lower interest rates, and collect payment of the deferred amounts. The securitization bonds are a formal contract between an EDU and a group of bond purchasers. In exchange for the bondholder purchasing the bonds, the EDU agrees to collect and repay the borrowed money with interest at fixed intervals. In this instance think of the utility as a middle-man, or pass through entity that collects the money from ratepayers and passes it to the bondholders to pay off the bonds. It is important to remember that this contract obligates the parties to it to perform, and does not bind or obligate the state or impair the state's financial rating in any way.

The deferred assets, particularly fuel, that electric utilities have on their books can be in the hundreds of millions of dollars and represent the costs associated with the generation of electricity to consumers that has already been consumed. What is more, these debts have previously been litigated and approved by the Commission through commission proceedings where the PUCO grants an EDU the right to collect those costs from ratepayers. Accordingly, SB 248 will allow a utility to securitize that approved and deferred debt at a Triple-A (AAA) rating as opposed to other types of debt financing, and do so at a materially lower interest rate. The AAA rating is the best possible rating and as such it results in the lowest interest-rate available on the bond market. The AAA rating maximizes the reduction of the cost of debt for ratepayers. As a point of comparison, currently the Weighted Average Cost of Capital is around 11.5% (which is commonly used when the utility is bearing a risk of getting ultimate cost recovery), the Commission's lowest interest form of financing, the Long-Term Debt rate is 5% (which

utility is essentially guaranteed cost recovery), whereas AAA rated bonds are currently hovering around a 3% interest rate (These rates have been below 4% for the past decade). So as you can see, by reducing the interest rate on the deferred debt, the potential savings to ratepayers through AAA-rated securitization bonds is great. While I am not a Wall Street bond lawyer, I know that several percentage points of interest savings on hundreds of millions of dollars of deferred assets valued can mean savings to rate payers of tens of millions of dollars throughout the life of the bonds.

In 2008, enactment of Senate Bill 221 allowed utility debt-securitization in Ohio. However, the securitization language was extremely broad and lacked specificity, so the highly desirable AAA rating could not be guaranteed when the bonds were placed on the market. Without the necessary degree of certainty provided by this legislation, EDUs have been unwilling or unable to pursue securitization as a meaningful alternative for debt financing in Ohio. Senate Bill 248 adds the necessary detail and clarity to the securitization process by identifying and improving upon the provisions which are necessary to ensure a AAA bond rating for Ohio utility securitization bonds. An example of one of the necessary provisions is on line 818, subsection (B), in which the final financing order is “irrevocable” and the Commission may not alter the terms of the bond after it has been issued. Another example can be found on line 1106, section (A), where similarly, the state “pledges” not to meddle with or impede a final financing order. There are several other instances throughout the bill in which you can find specific provisions that have been recommended to the Commission by bond firms, bond counsel, and other states that we have consulted during the course of crafting this legislation.

The language in SB 248 also describes in detail specifically what steps an EDU must take for the securitized bonds to be approved by the Commission. It is the Commission’s obligation to ensure that due process is ensured and the AAA rating can be achieved. In order to make certain members of the Committee are familiar with the Commission’s process, I will briefly walk you through the steps in the application process as it is laid out in the bill:

- 1.) The EDU comes to the Commission and applies to securitize a deferred debt either based on a previous electric security plan (ESP) or a separate financing hearing;

2.) Interested parties with standing are given a chance to weigh in on the application;

3.) After the interested parties weigh in on the application, the Commission, if it deems the application to be worthy and that ratepayers will benefit as a result, issues an order allowing the debt to be securitized.

4.) After the order is issued it may then be appealed by one of the aforementioned parties granted standing to the Ohio Supreme Court. At this point, the Court can either approve the Commission's order as it stands, or send it back to the Commission to modify, which would lead to beginning anew the previously referenced hearing process.

Only after the Commission rules on an order and there is no appeal, or the Supreme Court approves the Commission's order, does the bond get released and the debt is securitized.

Attached to your testimony is exhibit A, which describes in great detail the process in which a utility comes before the Commission to establish their rate schedule and also potentially have a deferral granted. Only after this extensive process, which is wholly separate from a finance proceeding, can a utility apply for securitization of a deferred asset. The application for securitization will then be considered in a separate proceeding from the aforementioned rate case.

As you can see there is a defined, deliberate process that must be strictly adhered to in order for a securitization application to move forward and be approved by the Commission. More importantly, there is an appeals process that includes an appeal to the highest court in our state for approval prior to bond issuance. There are also protections within the legislation that provide safeguards to protect the state from any financial responsibility to support or back the bonds in question. The most explicit example of one of these measures starts on line 1094 where it states that issuance of these bonds "shall not constitute a debt or a pledge of the faith and credit or taxing power of this state," or any of its subdivisions. Another example begins on line 1100 where it says that issuance of these bonds does not "obligate" this state or any of its subdivisions to "levy any tax or make an appropriation for payment of the principal of or interest on the bonds." We have been clear throughout the process that an application for securitization is not a "rubber-

stamp” process in which an EDU applies, the Commission checks the boxes, then issues an Order with little to no scrutiny. Quite the contrary, the EDU making application and other interested parties will all have an opportunity to make their case in a Commission proceeding, and every applicable appeal, prior to issuance of an Order permitting securitization. This legislation guarantees that due process is preserved during the securitization proceeding, while also ensuring a better interest rate on the deferred asset, thus leading to substantial savings for ratepayers.

Further, the Commission has the authority pursuant to the bill to evaluate any miscellaneous charges associated with legal fees or transaction costs, and will work to ensure the lowest amount possible for the transaction costs. Also, SB 248 stipulates that the state cannot interfere with the collection of the bonds after the extensive approval process has run its course, thus providing the bond market with the assurance necessary to grant the all important AAA rating. Moreover, sufficient safeguards have been put in place to ensure that the state’s creditworthiness is not jeopardized before, during, or after this process.

In closing, I would like to use a true but overused phrase in government to more concisely describe my thoughts on this bill by saying that I view securitization as an additional tool in the Commission’s toolbox. If a utility would like to securitize debt, and it is undeniably clear that it will result in cost savings to ratepayers over other accounting methods, then we at the Commission will have the tools to ensure customers experience those savings. Nineteen other states have adopted some form of securitization and their electric utility customers are currently benefitting from that action. As such, I encourage you to make Ohio the twentieth state that affords its ratepayers this opportunity by passing SB 248.

Again, I thank you for the opportunity to appear before you today and provide testimony as we at the Commission look forward to working with you and the other supportive and interested parties to make this the strongest and most beneficial legislation possible. I would also especially like to thank Chairman Daniels and Vice-Chairman Balderson for

their strong leadership and guidance throughout this process. I would be happy to answer any questions members of the committee may have at this time.

EXHIBIT A

Initiating a Rate Case

Why?

- By a company to obtain more revenue; by a customer through a complaint case; or by the PUCO through a Commission Ordered Investigation (COI)

How?

- Company makes a Pre-Filing Notice (PFN) and informs mayors and legislative bodies 30 days before filing the full application at the Commission
- Application filed no earlier than 30 days after the PFN – Company has the burden of proof in the request for an increase in rates
- Company files work papers, testimony and a set of proposed rates
- Company publishes notice once a week for 2 weeks in newspapers

Rate Case Steps

- Staff investigates the company's **expenses, revenues and investment**
 - **Revenue Requirement** – the amount of money that allows the company to cover expenses and earn a fair return on investment
 - **Rate Design** – how the revenue be collected from the various classes (residential, commercial, industrial) and based upon cost-of-service (i.e. the charge levied against a customer is proportional to the expense of service to the customer)

Rate Case Procedure

- **Staff Report** is filed - usually within 5 months of the application.
(not a statutory timeline)
- **Objections** to the Staff report must be filed within 30 days.
(supported by testimony)
- **Objections & Testimony frame the issues** – if not objected to, then Staff report carries the burden

The Parties to a Rate Case

- The Attorney General's office represents the PUCO Staff in the hearing and /or negotiations
- Office of Consumer's Counsel (state agency representing residential consumers)
- Commercial customers
- Industrial customers
- Cities

Rate Case Hearings

- Publish notice of upcoming hearings
- Two types of hearings:
 1. **Public Hearing:** the public gets to hear about the proposed rate change and make comments. Public hearings are held in the communities affected by the application.
 2. **Evidentiary Hearing:** an attorney examiner presides and witnesses testify to support their positions and are subject to cross-examination from other parties. PUCO staff testify at the evidentiary hearing in support of the staff report.

After the Hearings

- Parties file **briefs** with the Commission within a time established by the PUCO attorney examiner. Usually file initial briefs and reply briefs.
- PUCO attorney examiner writes an order and circulates it to the Commissioners. The Commissioners provide input and vote on the order at a commission meeting. **PUCO Order is issued within 275 days** of the application filing otherwise the company can put requested rates into effect subject to refund.
- **Applications for Rehearing** must be filed within 30 days. Any issue appealed to the Ohio Supreme Court must be raised in the application for rehearing

Appeal of Commission Order

- Appealing party must file a **notice of appeal** with the Ohio Supreme Court within 60 days of the date of denial of the application for rehearing by the Commission.
- No deadline in which the Court must act; however, the **Court must hear PUCO appeals**. Most appeals to the Ohio Supreme Court are discretionary – the court chooses what it will hear.
- Court can affirm/agree with the Commission order. Court can reverse the PUCO decision. Court can reverse and remand to the Commission

Rate Case Timeline

- Month 1 – Commission accepts the filing/application within 30 days, establishes test year & Staff investigation begins
- Month 5 – Staff Report filed
- Month 6 – Objections to Staff report filed within 30 days (with supporting testimony)
- Months 7 & 8 – Local public hearing & evidentiary hearing completed
- Briefs filed
- Month 9 – Commission issues decision (275 days)
- Applications for Rehearing before Commission
- Appeal to Ohio Supreme Court