

SUBJECT: Allowing expanded securitization financing by electric utilities

COMMITTEE: Regulated Industries — committee substitute recommended

VOTE: 8 ayes — P. King, Christian, Hartnett, Oliveira, Smithee, Straus, Swinford, Turner

0 nays

1 absent — Crabb

WITNESSES: For — Joseph B. McGoldrick, Association of Electric Companies of Texas; (*Registered, but did not testify*: Rudy Garza, TXU; Phillip Oldham, Texas Association of Manufacturers)

Against — None

On — Barry T. Smitherman, Public Utility Commission of Texas

BACKGROUND: In 1999, the 76th Legislature enacted SB 7 by Sibley, which restructured the electric utility industry in Texas to provide for competition in generation of electricity and in wholesale and retail sales. Transmission and distribution remain regulated through the Public Utility Commission (PUC).

Utilities Code, sec. 39.251 defines “stranded cost” as the difference between the net book value of generation assets and the market value of those assets. Utilities Code, sec. 39.252 permits electric utilities to recover their “net, verifiable, nonmitigable stranded costs” associated with purchasing and generating electric power.

Utilities Code, sec. 39.262 permits securitization of stranded costs in which the utility sells its debt to a third party. The utility receives a lump-sum payment, equaling the amount of the debt sold, from investors. Utility customers pay the principal and interest on the securitized debt over time rather than being assessed the full amount of the stranded costs immediately. This mechanism is designed to lower the carrying cost of the debt, as compared to conventional utility financing methods, by ensuring

that PUC will assess sufficient charges to the utility's customers to repay the debt.

As part of the transition to a competitive electricity market, the former monopoly utilities were permitted to recover some of their past investments made to serve all customers and assess a competitive transition charge (CTC). Some of those transition charges go to repay "stranded costs" from power plants or purchase of electric power. However, some of these investments are not related to generation of power, such as the cost of power lines or substations. Through a contested ratemaking process, the PUC determines the amount of historic investments not related to generating electricity and allows the utility to assess the CTC to recover these costs. Current state law does not allow for securitization of these non-stranded cost investments.

Centerpoint Energy, the former Houston Lighting & Power Company, currently is recovering approximately \$600 million in non-stranded cost balances through a CTC. In May 2006, AEP Texas Central Company, which serves a 44,000-square-mile area of south Texas, filed an application for a CTC that calls for a credit — rather than a surcharge — to customers of about \$475 million.

DIGEST:

CSHB 624 would amend Utilities Code, ch. 39 to allow securitization of CTCs that are not stranded costs. It also would strike all references to stranded charges and define CTCs as amounts determined by the PUC ratemaking process.

The bill would allow for refunding securitization bonds should a court overrule PUC's determination of eligible transition charges. Any readjustment would not affect the fees charged to customers required to repay the securitization bonds nor would it apply until all reviews by appellate courts were completed.

The bill would take immediate effect if finally passed by a two-thirds record vote of the membership of each house. Otherwise, it would take effect August 27, 2007.

**SUPPORTERS
SAY:**

CSHB 624 would allow the same financing mechanism used for stranded costs to be used for other CTCs. Through securitization, a utility can lock in its costs and sell that debt at a low rate of interest to other investors in the same way that homeowners refinance their mortgages. Current law that

permits securitization financing only for stranded costs is analogous to allowing refinancing only for a detached single-family home but not for a townhouse or condominium.

Utility consumers would see the benefit of securitization through lower utility rates. Securitization could lower financing costs from the current 8 percent being charged to rate of 5 percent. CenterPoint customers already are being assessed surcharges to finance the existing \$600 million debt. Refinancing that debt could result in a significant yearly savings of more than \$15 million.

Securitization reduces the risk for utility companies, investors, and Texas taxpayers. Utilities could reduce their debt and invest in improving service, and investors would be assured of a safe financial opportunity. The state would not assume any responsibility for repaying the balance on the bonds. Since 2001, Texas utilities have securitized more than \$6 billion and saved \$2.5 billion over the life of the bonds for stranded cost recovery. The same financing mechanism should be extended to other costs from the transition to a restructured electric market.

All current transition charges eligible for securitization were subject to review as part of a contested rate case before the PUC and the courts. Any other amounts would be subject to the same level of scrutiny. CSHB 624 would clear up confusion caused by previous PUC decisions and court rulings on securitization.

Both utility consumers and bond investors would be protected in the very unlikely case of bankruptcy of an electric utility. Another company would assume the responsibility both for the “wires” portion serving local electric customers and for making sure that the revenue dedicated to the bond repayment was used for that purpose. CSHB 624 includes a “fail safe” provision that would protect the revenue stream should an appeals court disallow PUC’s decision on these transition costs.

**OPPONENTS
SAY:**

Utilities should not be able to securitize additional transition costs. Once securitized bonds are issued, they are irrevocable. Utilities will have recovered those costs up front, rather than over time. Adjusting these costs could be difficult if it was determined upon appeal that the estimates were inaccurate.

NOTES:

During the 2005 regular session, the Senate passed SB 1495 by Fraser and Jackson, a very similar bill, by 31-0 on the Local and Uncontested Calendar, but it died in the House after being postponed twice after being set on the General State Calendar. Another bill containing similar provisions, HB 1777 by P. King, passed the House on May 4, 2005, but died in the Senate Business and Commerce Committee.

The substitute remove d two references to “stranded costs” that appear in the bill as introduced.