(The House considered SB 769 by Williams, the Senate companion bill, in lieu of HB 1378, the House version of the bill, which had been set on the daily calendar and was analyzed by the House Research Organization. The bill subsequently was enacted as SB 769.)

HOUSE RESEARCH ORGANIZATION bill analysis 4/6/2009

HB 1378
Thompson, Ritter, Allen, et al.
(CSHB 1378 by Solomons)

SUBJECT: Securitization to recover weather-related electric system restoration costs

COMMITTEE: State Affairs — committee substitute recommended

VOTE: 11 ayes — Solomons, Menendez, Cook, Farabee, Gallego, Geren, Harless, Hilderbran, Lucio, Maldonado, Swinford

0 nays

1 present not voting — S. Turner

3 absent — Craddick, Jones, Oliveira

WITNESSES: For — Theodore Bunting, Entergy Texas, Inc.; Brown Claybar, City of Orange; Phillip Oldham, Texas Association of Manufacturers; Thomas Standish, CenterPoint Energy; (*Registered, but did not testify:* John W. Fainter, Jr., Association of Electric Companies of Texas, Inc.; Stephen Minick, Texas Association of Business)

Against — Jim Boyle, Texas Coast Utilities Coalition, Alliance of Xcel Municipalities; Kristen Doyle, Cities Aggregation Power Project, South Texas Aggregation Project, Steering Committee of Cities Served by Oncor

On — Don Ballard, Public Utility Counsel; (*Registered, but did not testify:* Laurie Pappas, Office of Public Utility Counsel; Barry Smitherman, Public Utility Commission)

BACKGROUND: Current law requires that an electric utility file a base rate proceeding with the Public Utility Commission (PUC) in order to recover the costs of repairing their electric system and restoring service to their customers following a major weather-related event or natural disaster.

Securitization is a method of financing that utilizes a secure revenue stream, such as a surcharge on customers' bills, to recover costs rather than changing the base rate.

DIGEST:

CSHB 1378 would add a new subchapter to ch. 36 of the Utilities Code related to securitization for recovery of electric system restoration costs, or storm costs, by an electric utility. It would enable an electric utility to recover system restoration costs of $100 million or more without a base rate proceeding with the PUC and to use securitization financing to recover those costs, if approved by the PUC.

An electric utility seeking to use securitization for system restoration costs would use the same procedures, standards, and protections for securitization already outlined under subch. G, ch. 39 of the Utilities Code. The PUC would have authority over the amount of system restoration costs that a utility would be eligible to recover through securitization and the issuance of a financing order authorizing the request, including timelines, safeguards to ensure the most cost effective method of recovery, and restrictions on bypassability. CSHB 1378 also would provide standards and definitions relating to system restoration costs, instructions on appeal procedures of PUC decisions, and instructions on how system restoration costs would be allocated to customers with consideration to rate freezes and federal tax offsets.

Eligibility to recover and securitize system restoration costs. CSHB 1378 would authorize the PUC, by rule, to determine the amount of system restoration costs that would be eligible for a utility to recover and securitize. The PUC would be required, no later than 150 days after the utility filed an application, to issue a determination of the recoverable amounts.

An electric utility would file an application for a financing order authorizing the securitization of system restoration costs. The application could be filed before the expiration of the 150-day period to determine the amount eligible. The PUC would be required to issue a financing order within 90 days, but not until the amount eligible was determined.

During the proceeding for the financing order if the PUC determined that using securitization to recover system restoration costs would not be beneficial or cost-effective to ratepayers, the PUC would have to use the proceeding, rather than require a separate base-rate case, to allow the electric utility to recover its system restoration costs through a customer surcharge mechanism.

System restoration cost standards. System restoration costs would be defined as the reasonable and necessary costs incurred by an electric utility for the restoration of service and infrastructure resulting from electric

power outages due to weather-related events or natural disasters that took place in 2008, as well as future events.

System restoration costs would include reasonable estimates of costs that would be subject to true-up and reconciliation after the actual costs were known.

A utility would have to use any source of compensation for system restoration costs, such as insurance proceeds and governmental grants, to reduce the amount passed on to customers. The PUC would have to charge interest on the amount of compensation until it was used to reduce the amount securitized or otherwise reflected in the rates of the utility.

If insurance or government compensation was not received in time to offset the securitized amount or if the estimate of costs incurred was more than the actual cost, the PUC would be required to take the difference into account in future rate proceedings or could issue a separate tariff rider to credit the amounts against charges being collected from customers.

CSHB 1378 would require that system restoration costs include interest and finance charges from the date the costs were incurred until the date the transition bonds are issued or until costs are otherwise recovered.

The bill would authorize the proceeds of any transition bonds issued by the utility to be used only for the reduction of the amount of recoverable system restoration costs, including refinancing or retirement of utility debt or equity.

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 September 1, 2009.

SUPPORTERS SAY:

CSHB 1378 would expedite the recovery of costs and provide a more cost-effective means of recovery for utilities hit with system restoration costs due to natural disasters. The conventional method of recovering storm costs is for a utility to go through a base rate proceeding at the PUC, which takes 185 days to complete and often is costly due to litigation.

Base rate proceedings cause significant delays in the recovery of storm costs and place additional costs on the affected utilities, which are passed on to customers, including both the cost of the proceeding and high interest and finance charges.

Currently, a utility must receive approval from the Legislature through special legislation in order to recover system restoration costs through securitization. For example, HB 163 by P. King, enacted by 79th Legislature during its 2006 third called session, allowed Entergy to use securitization to recover costs resulting from Hurricane Rita in 2005. CSHB 1378 would authorize the PUC to approve the use of securitization without the utility having to wait for a legislative session to do so.

Securitization allows for very low interest rates on bonds that are issued to cover system restoration costs. It is a form of low-cost refinancing similar to refinancing a home mortgage. A utility issues bonds and pays off existing debt or reinvests the proceeds in its infrastructure. The securitized bonds that are issued are then paid off by the provider's retail customers. Securitization financing costs customers less money because the financing order provides terms and conditions that result in highly rated bonds with relatively low interest rates.

Securitization is a proven financial technique that has minimized the rate impact on Texas consumers by saving million of dollars in financing costs. Entergy used securitization to recover costs from the devastation caused by Hurricane Rita in 2005, resulting in an estimated savings of $300 million to consumers. With respect to recovering costs from the 2008 hurricane season, securitization is anticipated to reduce the monthly system restoration charges to a typical residential customer by approximately 20 percent as compared to conventional rate-setting methods.

CSHB 1378 would put protections in place to ensure that securitization would provide a better benefit to the utility and consumers than the conventional method of recovery. The PUC would have to find tangible and verifiable benefits before securitization was approved, and a trigger mechanism would set a threshold amount of recovery costs before securitization could become an option.

OPPONENTS SAY:

CSHB 1378 would speed up the cost-recovery process for electric utilities hit by natural disasters and could put the PUC under pressure to move more quickly than would be prudent. Time and consideration should

remain a high priority when decisions are made to pass costs onto consumers.

This bill would put a cost-recovery mechanism in place for storms that have yet to occur and for recovery of damages that currently are unknown. Securitization has always been an extraordinary means to recover extraordinary costs. This bill would open up the use of securitization to any storm or natural disaster before it could be known how best to proceed.

Securitization could be a disincentive for utilities and industry to engage in mitigation efforts, such as grid hardening, if they knew they would recover all of their costs.

CSHB 1378 would allow a utility to base securitization on only estimated costs. Estimates are unreliable and should not be the basis of securitization or surcharges. Should this be allowed, there at least should be mandatory rate cases every three years to capture any over-recovery.

If the PUC determined that a utility did not qualify for securitization, the utility would not have to go back to a standard base rate proceeding. This would allow a utility to bypass the traditional ratemaking process.

CSHB 1378 would allow a utility essentially to earn a double return on investment — for building and maintaining the electric system and for recovering costs to repair damages. Without a base rate proceeding, there would not be an opportunity to reconcile those amounts.

NOTES:

The companion bill, SB 769 by Williams, passed the Senate by 31-0 on March 25 and was reported favorably, without amendment, by the House State Affairs Committee on April 2, making it eligible to be considered in lieu of HB 1378.

The committee substitute reformatted the bill as filed and revised language to be consistent with existing law (secs. 39.458-39.463 of the Utilities Code) addressing securitization of recovery costs associated with Hurricane Rita in 2005.

The committee substitute would limit the use of securitization to instances in which an electric utility had incurred system restoration costs of $100 million or more in any calendar year after January 1, 2008. It removed all

references to the use of securitization to create, fund, eliminate shortages in, or replenish self-insurance reserves.

The committee substitute added deferred costs as reasonable and necessary system restoration costs and deleted internal or external labor costs.

The committee substitute added "any other sources of funding" to the list of amounts that, along with insurance proceeds and governmental grants, could reduce the amount recoverable. It also would allow the PUC to establish a tariff rider to credit those amounts if they were not received in time to reduce the amount recoverable. It would allow carrying costs to be part of system restoration costs until system restoration costs were otherwise recovered, rather than until transition bonds were issued.

The committee substitute removed a April 1, 2010, expiration date on the section relating to the 150-day period provided to the PUC to determine the amount eligible for recovery. It also would allow an electric utility operating under a rate freeze to defer system restoration costs and accrue interest.