SUBJECT: Securitizing default balances associated with the wholesale electric market

COMMITTEE: State Affairs — committee substitute recommended

VOTE: 11 ayes — Paddie, Hernandez, Deshotel, Harless, Howard, Hunter, Lucio, Raymond, Shaheen, Slawson, Smithee

0 nays

2 absent — P. King, Metcalf

WITNESSES: For — Catherine Webking, Texas Energy Association for Marketers; Michele Richmond, Texas Competitive Power Advocates; (*Registered, but did not testify*: Tony Horton and Marcie Zlotnik, Just Energy; Tom Oney, Lower Colorado River Authority)

Against — None

On — Jason Ryan, CenterPoint Energy; Shane Cawood, Hartman Income REIT; Katie Coleman, Texas Association of Manufacturers; (*Registered, but did not testify*: Daniel More, Guggenheim Partners; James Schaefer, Guggenheim Securities; Cyrus Reed, Lone Star Chapter Sierra Club; Thomas Parkinson)

DIGEST: CSHB 4492 would enable the independent organization certified by the Public Utility Commission (PUC) to perform certain functions related to the electric grid and electricity market in the ERCOT power region (ERCOT organization) to use securitization financing to fund substantial balances that would otherwise be uplifted to the wholesale market as a result of market participants defaulting on amounts owed after an extreme pricing event.

The bill would prohibit the ERCOT organization from reducing payments to or charging uplift short-paid amounts from a municipally owned utility that became subject to the jurisdiction of the organization on or after June 1, 2021, and before December 30, 2021, related to a default on a payment

obligation by a market participant that occurred before June 1, 2021.

Securitization of ERCOT organization. PUC would have to ensure that securitization provided tangible and quantifiable benefits to wholesale market participants, greater than would have been achieved absent the issuance of bonds, and that the structuring and pricing of the bonds would result in the lowest bond charges consistent with the terms of the applicable financing order.

Bond proceeds under the bill would be used solely for the purpose of financing default balances that otherwise would be or have been uplifted to the wholesale market.

Financing order. On application of the ERCOT organization, PUC could adopt a financing order to recover the costs of a substantial default balance of qualified costs resulting from a significant pricing event. PUC would have to find that such financing was needed to preserve the integrity of the wholesale market and the public interest after considering the interests of market participants who were owed balances and the potential effects of uplifting those balances to the wholesale market without a financing vehicle.

Under the bill, "qualified costs" would mean a default balance resulting from the period beginning 12:00 a.m., February 12, 2021, and ending 11:59 p.m., February 20, 2021, that otherwise would be or had been uplifted to other wholesale market participants, together with the costs of issuing, supporting, and servicing bonds and any costs of retiring and refunding existing debt in connection with the issuance of bonds.

PUC also could adopt a financing order, at the request of the ERCOT organization, providing for retiring and refunding the bonds after finding that the future default charges required to service the new bonds would be less than the future default charges required to service the refunded bonds.

A financing order would have to be issued within 90 days of a request from the ERCOT organization.

The financing order would have to detail the amounts to be recovered and the period, which could not exceed 30 years, over which the nonbypassable default charges would be recovered. Nonbypassable default charges would have to be collected from and allocated among wholesale market participants using the same methodology under which charges would otherwise be uplifted. The associated rate would be assessed on all market participants and could be based on updated transaction data to prevent participants from avoiding the nonbypassable default charges.

The financing order together with the default charges would be irrevocable and not subject to reduction, impairment, or adjustment, by further action of PUC. The bill would provide a process by which a financing order could be appealed.

Property rights. The rights and interests of the ERCOT organization under a financing order would be only contract rights until they were transferred to an assignee or pledged in connection with the issuance of bonds, at which time they would become default property.

Default property would constitute a present property right for contracts concerning the sale or pledge of property. All revenues and collections resulting from default charges would constitute proceeds only of the default property arising from the financial order.

The interest of an assignee or pledgee in default property and in associated revenues and collections would not be subject to setoff, counterclaim, surcharge, or defense by the ERCOT organization or in connection with the bankruptcy of a wholesale market participant or the organization.

True-up. The bill would require a financing order to include a mechanism that required the default charges be reviewed and adjusted at least annually within 45 days of the anniversary of the issuance of bonds to correct any over- or under-collections of the previous 12 months and ensure the expected recovery of amounts sufficient to provide for the

timely payment of debt service and other required charges.

Security interests. The creation, granting, perfection, and enforcement of liens and security interests in default property would be governed by the bill and not by the Business and Commerce Code.

Pledge of the state. Under the bill, the state would pledge that it would not take or permit any action that would impair the value of default property or the default charges until the principal, interest and premium, and other charges had been paid and performed in full.

Other provisions. Transactions involving the transfer and ownership of default property and the receipt of default charges would be exempt from state and local income, sales, franchise, gross receipts, and other taxes or similar charges.

An assignee or financing party could not be considered a public utility or person providing electric service by virtue of transactions under the bill.

Securitization corporation. The bill would create the Texas Electric Securitization Corporation as a nonprofit, special purpose public corporation and instrumentality of the state to provide a lower-cost financing mechanism for securitization under the bill.

Bonds issued under the bill would be the obligation solely of the issuer and the corporation as borrower and would not be a debt of or a pledge of the faith and credit of the state. Issued bonds also would be nonrecourse to the credit of assets of the state and PUC.

Administration. The corporation would have legal existence as a public corporate body and instrumentality of the state but would be separate and distinct from the state.

The corporation would be governed by a five-director board appointed by PUC for two-year terms. The corporation could retain professionals, financial advisors, and accountants to fulfill its duties. State officers and

agencies would be authorized to render services as requested by PUC or the corporation.

The corporation would be subject to PUC regulation and would have to submit an annual operating budget to PUC for approval.

Funding. The corporation would be self-funded, and its assets could not be considered part of any state fund. The state would be prohibited from budgeting for or providing any state money to the corporation. The corporation's debts, claims, obligations, and liabilities could not be considered to be a debt of the state or a pledge of its credit.

Before the imposition of charges to recover securitized amounts, the corporation could accept and expend money received from any source to finance obligations until it received sufficient property to cover its operating expenses and repay any short-term borrowing.

Powers and duties. The corporation could acquire, sell, pledge, or transfer property as necessary for the purposes of the bill and agree to related terms and conditions as it deemed proper.

The corporation also could, among other items listed in the bill, issue bonds consistent with a financing order, borrow funds from an issuer to acquire property and pledge that property to the repayment of any borrowing from an issuer or for initial operating expenses, and negotiate and become party to contracts as necessary, convenient, or desirable to carry out the bill.

The corporation would have to maintain separate accounts and records relating to each entity that collected charges for all charges, revenues, assets, liabilities, and expenses relating to that entity's related bond issuances.

The bill would require adequate protection and provision to have been made for the payment of outstanding bonds before the board could authorize any rehabilitation, liquidation, or dissolution of the corporation.

In the event of any such action, the assets of the corporation would be applied first to pay all debts, liabilities, and obligations, and all remaining funds would be applied and distributed as provided by PUC.

The corporation could not file a voluntary petition or become a debtor under federal bankruptcy law until two years and one day after the corporation no longer had any payment obligation to any bonds. These restrictions would not be limited or altered by the state and would be part of the contractual obligation that was subject to the state pledge for the benefit and protection of financing parties and the ERCOT organization.

Financing order. A financing order issued by PUC under the bill would have to:

- require the sale, assignment, or other transfer to the corporation of certain specified property and require that related charges paid be collected as the property of the corporation; and
- authorize the entity requesting securitization to serve as agent to collect the charges and transfer them to the corporation, the issuer, or a financing party.

The financing order also would have to authorize:

- the issuance of bonds by the corporation secured by a pledge of specified property, and the application of the bond proceeds, net of issuance costs, to the acquisition of the property from the entity requesting securitization; or
- the acquisition of specified property from the entity requesting securitization by the corporation financed either by a loan by an issuer to the corporation of the bond proceeds, net of issuance costs or by the acquisition by an issuer from the corporation of the property and in each case pledge the property to the repayment of the loan or bonds.

The corporation and any issuer would have to be a party to PUC's proceedings that addressed the issuance of a financing order, along with

the entity requesting securitization.

After issuance of the financing order, the corporation would have to arrange for the issuance of bonds as specified in the order by it or another issuer selected by the corporation and approved by PUC. Bonds issued pursuant to the order would be secured only by the related property and any other funds pledged under the bond documents. No assets of the state or entity requesting securitization would be subject to claims by bondholders. Following assignment of the property, the entity requesting securitization would not have any beneficial interest or claim of right in such charges or in any property.

Severability. Effective on the date the first bonds were issued under the bill, if any provision of the Public Utility Regulatory Act was held to be invalid or was invalidated, superseded, replaced, repealed, or expired for any reason, that occurrence would not affect the validity or continuation of the bill or other provisions of state law relevant to the issuance, administration, payment, retirement, or refunding of authorized securitization bonds or to any actions an entity requesting securitization. Those provisions would remain in full force and effect.

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, 2021.

SUPPORTERS SAY:

CSHB 4492 would minimize the impact of Winter Storm Uri on the state's wholesale electric market by allowing the ERCOT organization to use securitization financing to fund substantial balances that would otherwise be uplifted to the wholesale market as a result of market participants defaulting on amounts owed after the storm. Securitization is a tried and true method that has been used previously in Texas for electricity utilities.

One of the ERCOT organization's functions is to receive and issue payments to market participants. Currently, if a short-payed invoice remains in the market as a result of a market participant's inability to pay, there is an uplift mechanism that distributes the short-payed amount to all

market participants to pay off those debts. The uplift is limited to $2.5 million per month.

Many wholesale market participants incurred extraordinary costs in attempting to restore service during the winter storm, and the current short-pay amount would not allow the ERCOT organization to uplift the costs to the market in a reasonable amount of time due to the limitation on monthly uplift.

CSHB 4492 would not change the payment structure of how such payments would be made among market participants but simply authorize securitization to recover these extraordinary costs, which is the best solution for market participants as it would provide rate relief by extending the time frame over which the extraordinary costs would have to be recovered and lowering associated carrying costs. The securitization mechanism also would allow wholesale market participants who were owed money to be paid in a more timely manner.

CRITICS SAY:

CSHB 4492 effectively could amount to a bailout plan by using securitization to reallocate debts incurred by certain entities to the entire wholesale market, like a back door repricing of the market. The bill could make customers of entities that were hedged properly pay the debts of entities that short-payed in the market. Affecting market principles should be done only to prevent a complete market collapse, such as the bankruptcy of a majority of retail electric providers. Absent evidence of a total collapse, the market should be left to sort itself out rather than taking the approach of the bill, which could lead to unintended consequences.

OTHER CRITICS SAY:

CSHB 4492 should require that efforts first be made to recover default costs from applicable entities or for the ERCOT organization to resettle prices prior to securitization to ensure that the amount securitized was not greater than it should have been.

The bill would not go far enough to address all costs facing wholesale market participants as a result of the winter storm.