

Regulatory Considerations on Debt Securitization Financing

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Constitutional Responsibilities of the Public Regulation Commission (PRC)

- **NM Constitution, Article XI, Sec. 2. [Responsibilities of public regulation commission.]**

The public regulation commission shall have responsibility for regulating public utilities, including electric, natural gas and water companies; transportation companies, including common and contract carriers; transmission and pipeline companies, including telephone, telegraph and information transmission companies; and other public service companies in such manner as the legislature shall provide. The public regulation commission shall have responsibility for regulating insurance companies and others engaged in risk assumption as provided by law until July 1, 2013. (As added November 5, 1996; as amended November 6, 2012.)

Statutory Rate and Service Duties of New Mexico Utilities

- **NMSA 62-8-1. Rates.**

Every rate made, demanded or received by any public utility shall be just and reasonable.

- **NMSA 62-8-2. Service.** Every public utility shall furnish adequate, efficient and reasonable service.

Authority of PRC over Abandonments

- **NMSA 62-9-5. Abandonment of service.**

No utility shall abandon all or any portion of its facilities or the facilities' service]. . . without first obtaining the permission and approval of the commission. The commission shall grant such permission and approval, after notice and hearing, upon finding that the continuation of service is unwarranted or that the present and future public convenience and necessity do not otherwise require the continuation of the service or use of the facility; **In considering the present and future public convenience and necessity, the commission shall specifically consider the impact of the proposed abandonment of service on all consumers served in this state, directly or indirectly, by the facilities sought to be abandoned.**

Regulatory Compact

- Early on, to avoid inefficient redundant systems, states gave utilities exclusive revocable territorial rights, with the right and requirement to serve all customers in the area.
- The compact formed through evolving legal interpretations embodied in state and local statutes and case law.
- Not necessarily voluntary; evolving with changing circumstances.
- Represents exercise of state police power consistent with Commerce Clause and Federal Power Act.

“An Economic and Legal Perspective on Electric Utility Transition Costs,” K. Rose, NRRI, 1996, 41-43

Regulatory Compact

- For assuming its obligations, utility is granted an ***opportunity*** to earn reasonable return on its prudent investment and to recover its prudently-incurred expenses.
- Compact does not provide utility a legal right to recover ***all*** incurred costs or a return on its investments.
- No absolute guarantee that a reasonable return will be earned or that reasonable costs will be recovered.
- For return to be reasonable, must reflect risks imposed by compact on utility.

“An Economic and Legal Perspective on Electric Utility Transition Costs,” K. Rose, NRRI, 1996, 43-44

Regulatory Compact

- Even though utility must serve all customers, they have no obligation to buy service.
- Regulated utilities are not guaranteed recovery of costs that can't be recouped due to competition, obsolescence or abandonment.
- Opportunity to earn reasonable rate of return on investment is held in check by the used-and-useful and prudent-investment tests, as well as by competition from government ownership, fuel substitutes, and self-generation.

“An Economic and Legal Perspective on Electric Utility Transition Costs,” K. Rose, NRRI, 1996, 44, 59-68

PRC Review Process

- Utility files application for Commission action, such as plant closure approval or rate increase to pay for expenses for new or continuing capital investments – initiates “case” before PRC
- Utility is “Petitioner,” PRC Staff and other parties (Intervenors, such as large power users, consumer advocates, enviros) join case.
- Commission appoints Hearing Examiner, who acts like judge: holds hearing, hear testimony, creates full record; writes Recommended Decision for Commission to adopt/reject/modify

PRC Review Process

- Commission, based on HE's RD, determines reasonableness of any rate increase arising from Petitioner's request, considering that Petitioner is entitled to expenses and reasonable return on prudent capital investment in used-and-useful plant.
- In abandonment proceeding, same considerations apply.

PRC Review Process - Abandonment

- Notice and Hearing required.
- Commission shall specifically consider the impact of the proposed abandonment of service on all consumers served in New Mexico, directly or indirectly, by the facilities sought to be abandoned.
- Commission must review evidence for used and useful and prudent investment analyses.
- ***Separate from prudence analysis***, Commission must make a ***policy determination*** regarding how much of closure costs should be borne by shareholders compared to ratepayers.

Debt Securitization

- New type of bond: Ratepayer Obligation Charge (ROC) bond
- Involves direct borrowing by a ***non-regulated*** affiliate of utility to finance costs such as:
 - Unrecovered expenses due to plant closure (FL),
 - Unusual expenses such as storm damage (TX,)
 - Other expenses such as environmental plant upgrades (WV).

“Securitization Basics: A Tool for Transition from Coal to Renewables and for Grid Modernization,”
Powerpoint, J. Fichera, www.saberpartners.com, 3-5

Debt Securitization – Role of PRC

- Legislature authorizes PRC to issue an “irrevocable financing order,” (IFO), based on statutory creation of a property right in the bondholders to the payments. This property right, along with a statutory “state pledge” to not interfere with bondholders rights to receive the payments, permits ***future PRC Commissioners to be bound by this Order.***
- Commission states in IFO that it shall authorize and adjust a special charge on all ratepayers to collect sufficient revenues to pay principal and interest on the bonds until they are repaid in full.
- This new statutory authority and PRC’s authority to regulate electricity rates authorizes Commission to order the ROC to be imposed, billed, collected and paid to bondholders.

Debt Securitization – Impact on Ratepayers

- Irrevocable charge appears on ratepayers' monthly bill and cannot be removed by future Commission action; as a result, bonds are rated AAA.
- The ROC bonds (debt financing) are paid back at a rate lower than PRC-determined rate based on rate-making process (debt + equity financing).
- Ratepayers assume all risk associated with payment of the ROC bonds – utility's risk disappears when it receives financed up-front lump sum of cash payment for closure costs.

Debt Securitization – Continuing Regulatory Duties of PRC

- PRC has no authority over bond issuance and management.
- PRC's authority and duties in abandonment proceeding prior to bond issuance is not affected:
 - Must still hold hearing, analyze and weigh expert evidence in determining used/useful status of plant and prudence of expenditures spent between last Commission approval and date of abandonment.
 - Must still make policy decision on risk sharing between ratepayers and shareholders for payment of closure costs.

Debt Securitization-PRC Ratepayer Protection

- Until bonds issue, PRC must continue to protect ratepayer interests:
- Hold abandonment proceeding and determine prudence of investments and cost sharing between ratepayers and shareholders.
- Impose transparency into negotiation of ROC bonds by participation in negotiations on the structure, pricing and marketing of bonds, assisted as necessary and without limit by market expert of Commission's choosing.

Thank You!