

State of Florida



Public Service Commission

CAPITAL CIRCLE OFFICE CENTER • 2540 SHUMARD OAK BOULEVARD
TALLAHASSEE, FLORIDA 32399-0850

-M-E-M-O-R-A-N-D-U-M-

DATE: September 9, 2015

TO: Carlotta S. Stauffer, Commission Clerk, Office of Commission Clerk

FROM: Rosanne Gervasi, Senior Attorney, Office of the General Counsel

RE: Errata Sheets for Testimony of Paul Sutherland and Hyman Shoenblum filed in Docket No. 150171-EI

Attached for filing in the above-referenced docket are errata sheets for staff witnesses Paul Sutherland and Hyman Schoenblum, including revised exhibits to their testimony.

Also attached is a corrected certificate of service, showing that the testimony of Paul Sutherland was filed and furnished to the parties on September 4, 2015. (A duplicate certificate of service of staff witness Hyman Schoenblum's testimony was inadvertently attached to, and filed with, the testimony of witness Sutherland.)

Please contact me if you have any questions regarding this filing.

Attachments

cc: Parties of Record

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

DOCKET NO. 150171-EI

ERRATA SHEET

WITNESS: **PAUL SUTHERLAND – STAFF**

<u>PAGE NO.</u>	<u>LINE NO.</u>	<u>CHANGE</u>
3	23	Change “RRBs not ABS for Financial Reporting” to “Securitized Utility Property Not A Financial Asset;”
3	24	Change “Exhibit No. ____ (PS-1c), FASB ASC;” to “Exhibit No. ____ (PS-1b), Accountants Handbook;”
3	25	Change “Exhibit No. ____ (PS-1b), Accountants Handbook;” to “Exhibit No. ____ (PS-1c), FASB ASC;”
4	9	Delete line.
4	10	Delete line.
4	13	Change “Credit Spreads for Auto Loan ABS vs. Credit Card ABS;” to “Saber Partners Report – Analysis of Ohio Power Pricing;”
4	23	Change “2010 to Present; and” to “Spreads – Citigroup vs. J.P. Morgan;”
4	24	Change “Exhibit No. ____ (PS-20), Utility Securitization Transactions since 1997.” To “Exhibit No. ____ (PS-19a), AEP Sidley MS Email; and”
4	25	Add ““Exhibit No. ____ (PS-20), Utility Securitization transactions since 1997.”
8	11	Change “that securitized” to “that the property collateralizing the securitized”
8	11-12	Change “as” to “as ‘financial assets,’ and those bonds therefore should not be treated”

WITNESS: **PAUL SUTHERLAND – STAFF**

Docket No. 150171-EI

Errata Sheet

Page 2

<u>PAGE NO.</u>	<u>LINE NO.</u>	<u>CHANGE</u>
8	12-13	Change “See Exhibit No. ____ (PS-1a), attached to my testimony.” to “See Exhibit Nos. ____ (PS-1a), ____ (PS-1b), and ____ (PS-1c), attached to my testimony.”
12	8	Change “formula, either” to “formula, usually either”
14	13	Delete “____ (PS-2).”
15	6	Delete “Please.”
15	17	Delete “have been”
25	15	Change “period)” to “period, excluding the 2012 CenterPoint transaction)”
32	10	Change “(PS-12).” to “(PS-15).”
35	14	Delete “See my”
44	7	Change “(PS-19),” to “(PS-19a),”
Exh (PS-1)		Replace Exhibit with color version of same Exhibit
Exh. (PS-1a)	Title	Change to “Securitized Utility Property Not a Financial Asset”
Exh. (PS-1b)		Replace Exhibit with color version of same Exhibit
Exh. (PS-3)		Replace Exhibit with color version of same Exhibit
Exh. (PS-4)		Replace Exhibit with color version of same Exhibit
Exh. (PS-5)		Replace Exhibit with color version of same Exhibit
Exh. (PS-6)		Replace Exhibit with color version of same Exhibit
Exh. (PS-6a)		Replace Exhibit with color version of same Exhibit
Exh. (PS-7)		Replace Exhibit with color version of same Exhibit
Exh. (PS-7a)		Delete (Exhibit was inadvertently included)
Exh. (PS-8)		Delete (This is a duplicate of Shoenblum’s Exhibit No. ____ (HS-1))

WITNESS: **PAUL SUTHERLAND – STAFF**

Docket No. 150171-EI

Errata Sheet

Page 3

<u>PAGE NO.</u>	<u>LINE NO.</u>	<u>CHANGE</u>
Exh. (PS-9)		Replace Exhibit with color version of same Exhibit
Exh. (PS-10)		Replace Exhibit with color version of same Exhibit
Exh. (PS-11)	Title	Change to “Saber Partners Report – Analysis of Ohio Power Pricing” and
Exh (PS-11)		Replace Exhibit with color version of same Exhibit.
Exh. (PS-12)		Replace Exhibit with color version of same Exhibit
Exh. (PS-13)		Replace Exhibit with color version of same Exhibit
Exh. (PS-14)		Replace Exhibit with color version of same Exhibit
Exh. (PS-17)		Replace Exhibit with color version of same Exhibit
Exh. (PS-17a)		Replace Exhibit with color version of same Exhibit
Exh. (PS-18)		Replace Exhibit with color version of same Exhibit
Exh. (PS-19)	Title	Change to “10-Year AAA Stranded Assets Spreads – Citigroup vs. J.P. Morgan” and
Exh. (PS-19)		Replace Exhibit with color version of same Exhibit
Exh. (PS-19a)		Add new Exhibit ____ (PS-19a)

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

DOCKET NO. 150171-EI

ERRATA SHEET

WITNESS: **HYMAN SCHOENBLUM – STAFF**

<u>PAGE NO.</u>	<u>LINE NO.</u>	<u>CHANGE</u>
18	22	Change “the testimony of witness Rebecca Klein” to “pages 43-44 of witness Paul Southerland’s testimony, his Exhibit No. _____ (PS-19a), and the testimony of witness Rebecca Klein”
Exhibit		Delete first Exhibit attached to the testimony, the Wisconsin Study of Saber (HS-2), as this is a duplicate exhibit.

Glossary of Finance Terms for Nuclear Asset-Recovery

Bonds

Asset-backed security (ABS) - A debt security issued by a special purpose entity, the payment of which is backed by a fixed pool of physical assets (e.g., rail cars or airplanes) or a financial assets (e.g., a mortgage or the value of a portfolio of credit card receivables). Utility securitization bonds are not asset-backed securities but often have historically been treated as such to the detriment of ratepayers.

Bankruptcy-remote - A bankruptcy remote entity that is designed in such a way that (i) the likelihood of it going into bankruptcy is extremely small, and (ii) it would experience as little economic impact as possible in the event of a bankruptcy of other related legal entities.

Basis point (bp) - One one-hundredth of a percentage point, often referred to in writing as “bp” (or “bps” in the plural). Traders refer casually to this as “bps.”.

Benchmark - When pricing a bond, the benchmark is a security with lots of price transparency that is agreed upon by all parties so that the yield on the new issue can be set relative to the yield on the benchmark. In that way, if yields in the market move after agreeing on the spread to benchmark but before final pricing, the parties do not have to renegotiate the final price/yield. A benchmark can also be a similar security used to determine relative value when talking to investors.

Callable/non-callable bonds/pre-payment risk - In many cases bonds are offered for sale with a “call provision.” For example, a company may want the right to retire a given bond issuance in five years even though it carries a 25-year maturity. That bond issuance would be said to carry a five-year call option. Investors who worry their bonds might be called away from them in a relatively short period of time will not pay a high price for those bonds because they can’t rely on earning the bonds’ stated interest rate through maturity. Also known as “pre-payment risk. Non-callable bonds cannot be called away from the investor until the final maturity date. Nuclear Asset-Recovery Bonds typically are non-callable and therefore have no pre-payment risk.

Final *scheduled* maturity date - The date by which it is expected the final principal payment on a bond or on a group of substantially identical bonds will be made. If this date is missed, it is not an event of default.

Final *legal* maturity date - The date by which, if the principal is not fully paid, the bonds will be considered to be in default. Usually, the final legal maturity date is one to two years after the final scheduled maturity date. Somewhat confusing, but the scheduled versus legal final maturity is meant to account for potential uncertainty in receiving cash from assets supporting debt service.

Irrevocable financing order - A finance order issued by state regulators that cannot be changed or revoked at a later date as long as the securitization bonds are outstanding, and which (i) segregates a specific component of the retail rate or charge which is imposed through out the service territory, (ii) causes the right to receive this rate component to be treated as an interest in property that can be bought, sold or pledged, (iii) authorizes the utility to sell such property to an SPE, (iv)

authorizes the SPE to issue debt secured by such property, and (v) requires the utility which sold the property to use the proceeds of the sale for a specific purpose.

Maturity - The length of time the bond issuer has to repay specified amounts to the lender/investor. after which time, an event of default would occur and the investor would get creditor rights to sue for repayment.

Nominal Dollars or Nominal Savings - This type of measure reflects the current situation, not adjusted for the opportunity cost of funds over time. Nominal dollars treat all dollars the same whether received today or 10 years from today. See “present value” for the way to look at dollars over time.

Present value - The amount of cash today that is equivalent in value to a payment, or to a stream of payments, to be received in the future. To determine the present value, each future cash flow is multiplied by a present value factor. For example, if the opportunity cost of funds is 10%, the present value of \$100 to be received in one year is $\$100 \times [1/(1 + 0.10)] = \91 . Opportunity cost means what a dollar today could earn over a specific period of time.

Regression Line - Regression takes a group of data points and tries to find a mathematical relationship between them. This relationship is typically in the form of a straight line (linear regression) that best approximates all the individual data points.

Relative value - The relationship between two securities' value in the market place. In pricing a new bond issue, for example, it is useful to compare the spread over swaps (see these definition below) of the proposed bond yield to the spread over swaps of a AAA-rated US agency bond. If the two securities were judged equal in risk with identical terms (not callable, same weighted average life, etc.), but one had a higher spread, it would be said to have greater relative value to the buyer.

Road show - A formal presentation to potential investors/ purchasers of a security, typically organized by underwriters with the involvement of the issuer and the financial advisor. A team sometimes travels around the U.S. to discuss the features of the security, resulting in the term “Road Show.” Sometimes the team travels to foreign financial centers to make these presentations. In recent years, most Road Shows have been conducted using electronic media over the Internet, reducing or eliminating the need for travel though in person presentations are can be more effective.

Secondary market - The market in which stocks or bonds are traded after their initial issuance. The primary market is when the underwriters purchase the bonds from the issuer (i.e., the initial issuance mentioned above), and then sell the bonds into the market place. When a bond trades at a substantially higher price (lower yield) in the secondary market immediately following its issuance, this is an indication it was mispriced (priced too low) by the underwriters.

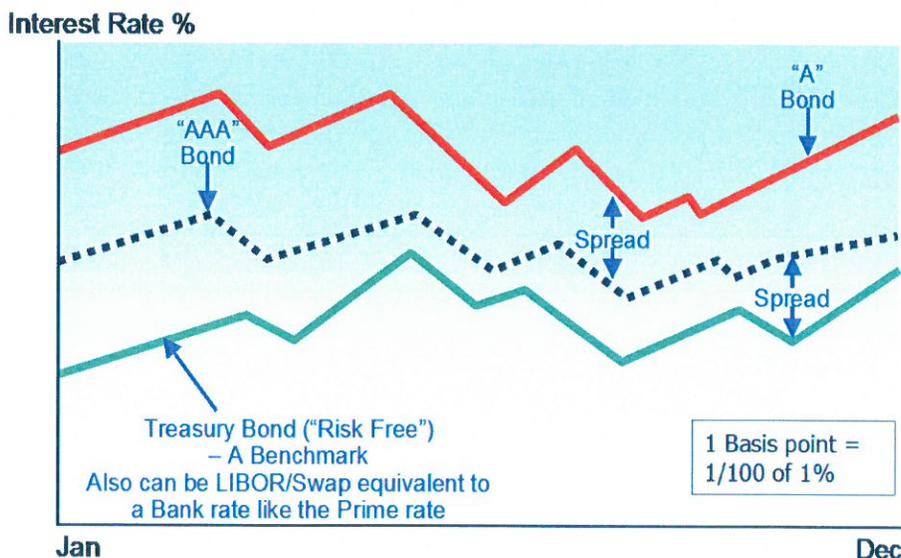
Securitization - The process by which a specific pool of assets, such as loan receivables, is used as a basis for issuing highly-rated (often AAA) bonds. The finite pool of assets is usually created and transferred to a trust or, in a utility securitization, to a bankruptcy remote entity, known as a special purpose entity (SPE). The entire right, title and interest in the assets is transferred at a fair market value to the SPE. The SPE pledges the assets to secure the bonds, and the cash flows from those assets are used to pay principal and interest on the bonds. Thus, the risk to the bondholder is just the risk associated with the cash flows from the assets in the SPE. The assets can be physical

(such as plant and equipment) or intangible (such as a loan receivable or the right to some other revenue stream).

Special purpose entity (SPE) - A bankruptcy remote (see **bankruptcy remote** definition, above) legal entity set up for the express purpose of owning the right, title and interest in the assets used to secure the bonds and provide the cash flows to pay interest and principal on the bonds.

Spread - The difference between the market yields of different fixed income securities of similar maturities, usually expressed in basis points. If a Treasury bond maturing in seven years is trading to yield 3.87%, and a AAA-rated corporate bond maturing in seven years is trading to yield 4.25%, the corporate bond is said to trade at a 38 basis point spread to the Treasury bond ($4.25 - 3.87 = .38$).

Spread is the easiest way to compare the cost of funds represented by different debt securities with similar structural characteristics. Participants usually will refer to the spread “relative to Treasuries” or “relative to swaps” as the most meaningful way to compare a given debt security to the most liquid, most secure, and most easily available benchmark for a given maturity. Spreads are often referred to as either “tight” or “wide” to the benchmark. (See **Tight spread/Wide spread** definition below.)



Swaps, or interest rate swap agreements - An interest rate swap exchanges a floating rate for a fixed rate on bonds. Under certain market conditions, a combination of floating-rate bonds and fixed-rate swaps could produce a lower overall “synthetic” fixed interest rate for ratepayers. Certain investors prefer a floating rate, while other investors prefer a fixed rate. For example, many European investors prefer a floating rate. There may be an opportunity to lower overall ratepayer costs by issuing floating-rate nuclear asset-recovery bonds and swapping them to a synthetic fixed rate.

Tranche - A tranche is a piece of a larger bond offering with its own cash flows, i.e. principal amount, maturity and interest rate, but governed by the same documents as the larger bond offering, i.e. prospectus, trust agreement, servicing agreement, etc.

Tight spread/Wide spread - If a spread is considered “tight,” it is low and closer to the benchmark rate. If it is “wide,” the interest rate is much higher than the benchmark rate. Interest

SABER PARTNERS, LLC

rates are composed of the benchmark plus the spread. Thus, a tight spread means a lower interest rate. Issuers want a tight spread, while buyers prefer a wide spread.

True-Up Period - The time in which nuclear asset-recovery charges and costs involved in an agreement are revised after the commencement of the contract. For instance, within 180 days after the commencement date, the parties will agree to revise the nuclear asset-recovery charges based on actual experience over the past 180 days. In this example, this will be done at the end of every future 180-day period.

Underwrite - This refers to the actions of an investment bank when it initially purchases newly issued bonds with the intention of re-offering or re-selling them to the ultimate investors in the secondary market; thus the investment bank is hoping to assume the market risk for a short period of time. In order to actually underwrite bonds, underwriters need to have capital at risk,

Underwriters - Investment banks that initially purchase the bonds and re-offer the bonds in the secondary market to the ultimate investors and put their capital at risk in doing so. A lead underwriter (sometimes called the "book-running" manager and most often called a "lead manager") is responsible for assembling and leading a syndicate that generally includes additional investment banks in an effort to reach the widest audience of buyers. A "co-lead underwriter" (or "co-manager") is another firm that also assumes responsibility to purchase the bonds from the issuer. Nowadays, in practice, the underwriters of a bond issue often have orders for 100% of a new issue before it is sold to anyone, and consequently the underwriters do not hold the bonds or take any appreciable market risk. This enables the underwriters to be rid of the risk they would otherwise assume. Underwriters are paid for taking risk, so when they price the bonds to "fly out the door," (i.e., little or no risk to the underwriter, many times oversubscribed) this is not a good thing for ratepayers. Example: If one puts his home up for sale, and it sells the first day, he can be relatively certain he did not receive the best price for his home even though his real-estate broker was paid handsomely.

Weighted average life (WAL) - The amount of time (in years), on average, the principal amount will remain outstanding. It is calculated by weighting the time each component of the principal is outstanding times the principal amount. Thus, for a bond that pays back all its principal at final maturity, the WAL is the same as the final maturity. However, utility securitization bonds amortize principal over a number of years, so the WAL is always less than the final maturity of the bond.

Yield, current - The annual coupon amount of interest on a bond, divided by the selling price (expressed as a percentage). A \$1,000 principal amount bond that sells for \$1,000 with a \$50 annual interest coupon has a 5% yield. The lower the price, the higher the yield; the higher the price, the lower the yield.

Yield to maturity - Yield to maturity is the discount rate at which the sum of all future cash flows from the bond (coupons and principal) is equal to the price of the bond. This measure of yield takes into account the difference between the current price and the principal value at redemption. This is the yield referred to when pricing a bond and comparing to the yield on benchmark securities. It is more reflective of true value because it accounts for the time value of money.

2007
CCH ACCOUNTING FOR
FINANCIAL ASSETS
AND LIABILITIES:
SALES, TRANSFERS,
AND EXTINGUISHMENTS

JOHN E. STEWART, CPA
JAMES F. GREEN, CPA
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THE ACCOUNTING RESEARCH
MANAGER GROUP

 CCH
a Wolters Kluwer business

Part I: Statement 140 Interpretations

Paragraphs 1 to 8

Question: Is a transfer of trade receivables for which the related goods or services have been provided, but for which the related receivables have not been billed, a transfer of financial assets that is accounted for under Statement 140?

Response: Yes. A common situation that creates unbilled receivables is when a utility company is able to recognize revenue for the service it provides to its customers but, due to its billing cycle, the customers are not invoiced until a later date. Since the utility has provided the service to its customer, it has a contractual right to receive payment for services rendered and generally would have recognized the related sale of electricity as revenue. Thus, unbilled receivables are recorded financial assets, the transfer of which would be accounted for under Statement 140. One possible technique to determine whether the would-be transferor has a contractual right to receive payment equal to the amount of the unbilled receivable would be to confirm the existence of the receivable amount with a sample of customers.

4-12. Securitization of Regulatory Assets

Summary: Regulatory assets (often called stranded costs) are not financial assets and therefore are not covered by Statement 140. The SEC staff believes EITF Issue No. 88-18, "Sales of Future Revenues," covers them.

Question (from FASB Staff Implementation Guide, Question 6):

The deregulation of utility rates charged for electric power generation has caused electricity-producing companies to identify some of their electric power generation operations as "stranded costs." Prior to deregulation, utilities typically expected to be reimbursed for costs through regulation of rates charged to customers. After deregulation, some of these costs may no longer be recoverable through unregulated rates. Hence, such potentially unrecoverable costs often are referred to as stranded costs. However, some of those stranded costs may be recovered through a surcharge or tariff imposed on rate-regulated goods or services provided by another portion of the entity whose pricing remains regulated.

Some entities have securitized their enforceable rights to impose that tariff (often referred to as "securitized stranded costs"), thereby obtaining cash from investors in exchange for the future cash flows to be realized from collecting surcharges imposed on customers of the rate-regulated goods or services. Are securitized stranded

Paragraphs 1 to 8

Part I: Statement 140 Interpretations

costs considered to be financial assets, the transfer of which would be within the scope of Statement 140?

Response (from FASB Staff Implementation Guide, Question 6):

No. Paragraph 364 defines *financial asset* as "... a contract that conveys to a second entity a *contractual right* (a) to receive cash or another financial instrument from a first entity or (b) to exchange other financial instruments on potentially favorable terms with the first entity" (emphasis added). Therefore, to be a financial asset, an asset must arise from a contractual agreement between two or more parties, not by an imposition of an obligation by one party on another. This notion in Statement 140 is consistent with the notion discussed in paragraph 39 of FASB Statement No. 105, *Disclosure of Information about Financial Instruments with Off-Balance-Sheet Risk and Financial Instruments with Concentrations of Credit Risk*,² which stated:

Other contingent items that ultimately may require the payment of cash but do not as yet arise from contracts, such as contingent liabilities for tort judgments payable, are not financial instruments. However, when those obligations become enforceable by government or courts of law and are thereby contractually reduced to fixed payment schedules, the items would be financial instruments under the definition.

Securitized stranded costs are not financial assets, and therefore transfers of securitized stranded costs are not within the scope of Statement 140. Securitized stranded costs are not financial assets because they are imposed on ratepayers by a state government or its regulatory commission and, thus, while an enforceable right for the utility, they are not a *contractual* right to receive payments from another party. To elaborate, while a right to collect cash flows exists, it is *not the result of a contract* and, thus, not a financial asset. Refer to Question 7 [Interpretation 2-4].

² Although Statement 105 was superseded by FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*, the Board's definition of *financial asset* continues to be based on the definition of a financial instrument found in Statement 105.

Commentary: We discussed this issue with the SEC staff before the issuance of the FASB Staff Implementation Guide on Statement 125 (which preceded the Statement 140 FASB Staff Implementation

Part I: Statement 140 Interpretations

Paragraphs 1 to 8

Guide). The SEC staff concluded that regulatory assets are not financial assets. The staff believes the legislation that provides for the securitization of regulatory assets simply allows the utility's regulatory authority to impose a tariff on electricity sold in the future. The law, however, does not transform regulatory assets into financial assets since they generally do not qualify to be accounted for as revenue until they are "billable" to the customer. The basis for the SEC staff's conclusion is that the resulting law creates an enforceable right (which is a right imposed on one party by another, such as a property tax), but not a contractual right. The SEC staff, after consulting with the FASB staff, concluded that the FASB specifically limited financial assets to contractual rights to cash or other financial assets, which are essentially a subset of enforceable rights. Thus, such an enforceable right does not meet the definition of a financial asset.

The SEC staff also concluded that the proceeds received by the utility do not represent cash for assets sold, but cash received for future services. This approach effectively precludes accounting for this type of a transaction as a sale outside of Statement 140. The SEC staff believes the proceeds represent debt. EITF Issue No. 88-18, "Sales of Future Revenues," provides the most relevant guidance to make that determination (see Interpretation 4-9).

4-13. Transfers of Minimum Lease Payments Under an Operating Lease

Summary: Transfers of contractual payments receivable under an operating lease are not within the scope of Statement 140.

Question (from FASB Staff Implementation Guide, Question 1):

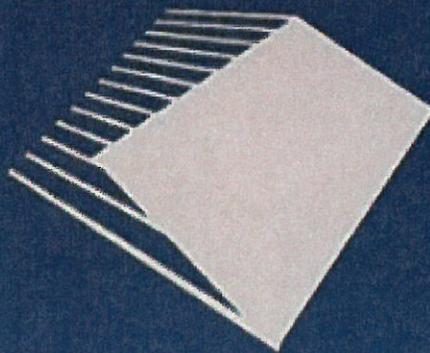
If a right to receive the minimum lease payments to be received under an operating lease is transferred, could it be considered a financial asset within the scope of Statement 140?

Response (from FASB Staff Implementation Guide, Question 1):

No. A right to receive the minimum lease payments to be received under an operating lease is an unrecognized financial asset. As stated in paragraph 4, Statement 140 "does not address... transfers of unrecognized financial assets, for example, minimum lease payments to be received under operating leases."

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36 40 REGULATED UTILITIES

asset's carrying amount and subsequently allocated to expense over that asset's useful life. ASC Topic 410 includes special provisions for entities that apply ASC Topic 980. Differences between amounts collected through rates and amounts recognized in accordance with ASC Topic 410 were recognized as regulatory **assets** and liabilities if the requirements of ASC Topic 980 were met.

(v) Securitization of Stranded Costs, Including Regulatory Assets. In connection with the electric industry restructuring efforts that occurred in a number of states, regulatory mechanisms were established to mitigate potential **stranded costs**. The legislative or regulatory framework for moving to a competitive marketplace included provisions when issued for the affected companies to securitize or "monetize" all or a portion of their **stranded costs** through the issuance of debt securities that would provide the utility with a lower cost of capital than that to which they were previously exposed. Generally, such provisions establish a separate unbundled revenue stream from the current bundled stream, surcharge, or tariff that would be the source of recovery from a company's rate payers for the **stranded costs**. Companies securitize their rights to impose such revenue stream, surcharge, or tariff by receiving cash flows from investors in exchange for future cash flows to be collected from customers. The utility would issue debt obligations in an amount equal to its **stranded costs** (or portion thereof). The resulting debt obligations would be nonrecourse since the company would sell the **stranded costs** to a credit-enhanced, bankruptcy remote special-purpose entity or trust established to finance the purchase through the sale of state-authorized debt. Collections of the tariff by the company would be passed through to holders of the debt as periodic payments of interest and principal.

The potential benefits to a company from securitizing **stranded costs** include the opportunity to improve credit quality and to use the proceeds to reduce leverage and fixed charges, or fund the termination of uneconomic contracts. The expectation is that monetizing the **stranded costs** would result in lower rates for consumers since higher cost of capital is effectively replaced by traditional utility debt with lower cost.

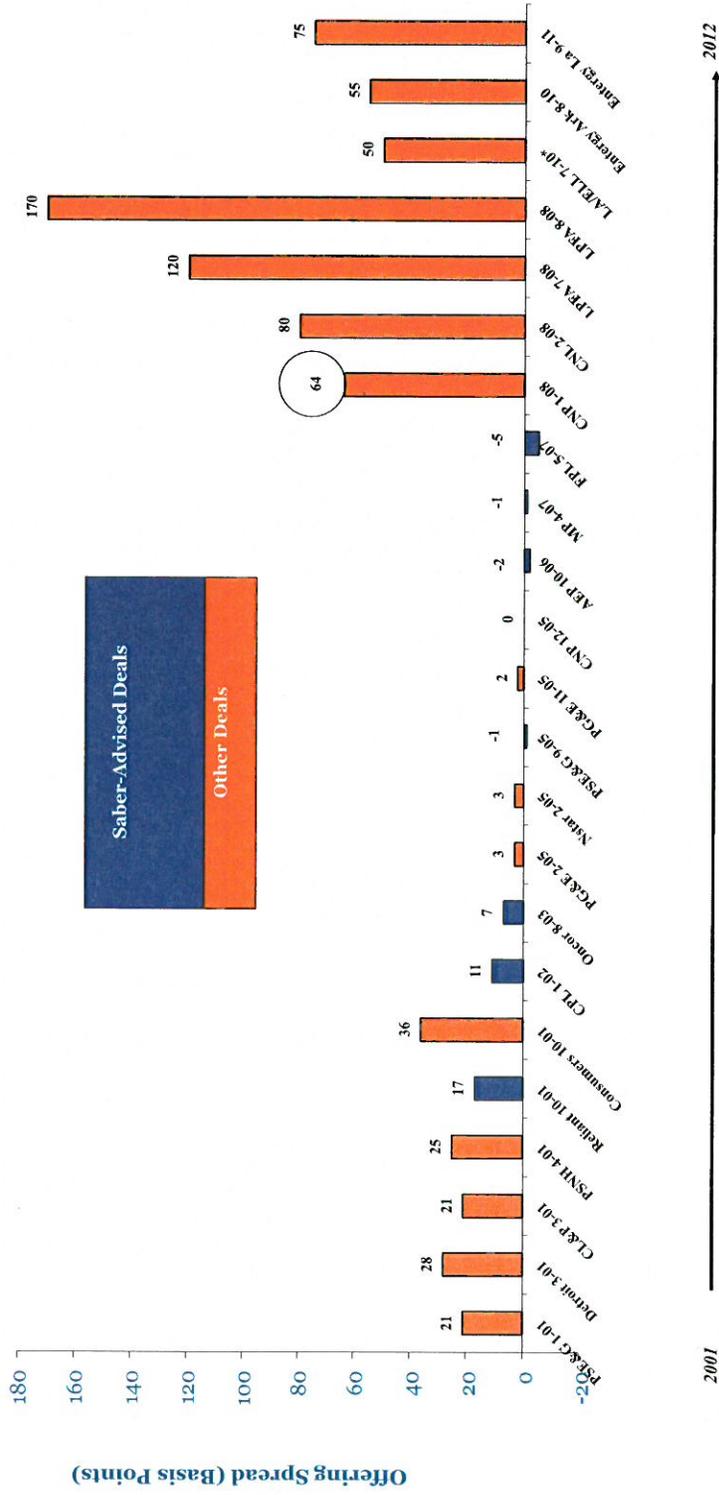
In February 1997, the SEC's Office of Chief Accountant provided **financial** reporting guidance to California's utility registrants for proceeds received in connection with a **stranded** cost securitization. The SEC Staff concluded that the proceeds received should be classified as either debt or deferred revenue based on the guidance in ASC Topic 470-10-25, *Debt*.

ASC Topic 470-10-25 reached a consensus that the presence of any one of six specifically identified factors independently creates a rebuttable presumption that classification of the proceeds as debt is appropriate. The facts and circumstances of **stranded** cost securitization transactions will typically result in the presence of one or more of the factors. Thus, securitization proceeds are generally expected to be classified as debt for **financial** reporting purposes.

ASC Topic 470-10-25 also concluded that amounts recorded as debt should be amortized under the interest method. Generally, this will result in an increasing amount of **stranded** cost recognition in the income statement during the securitization period. This occurs because the amount recognized will equal the principal portion (on a mortgage basis) of the tariffed debt service cost that is billable to customers and recorded as revenue during each period.

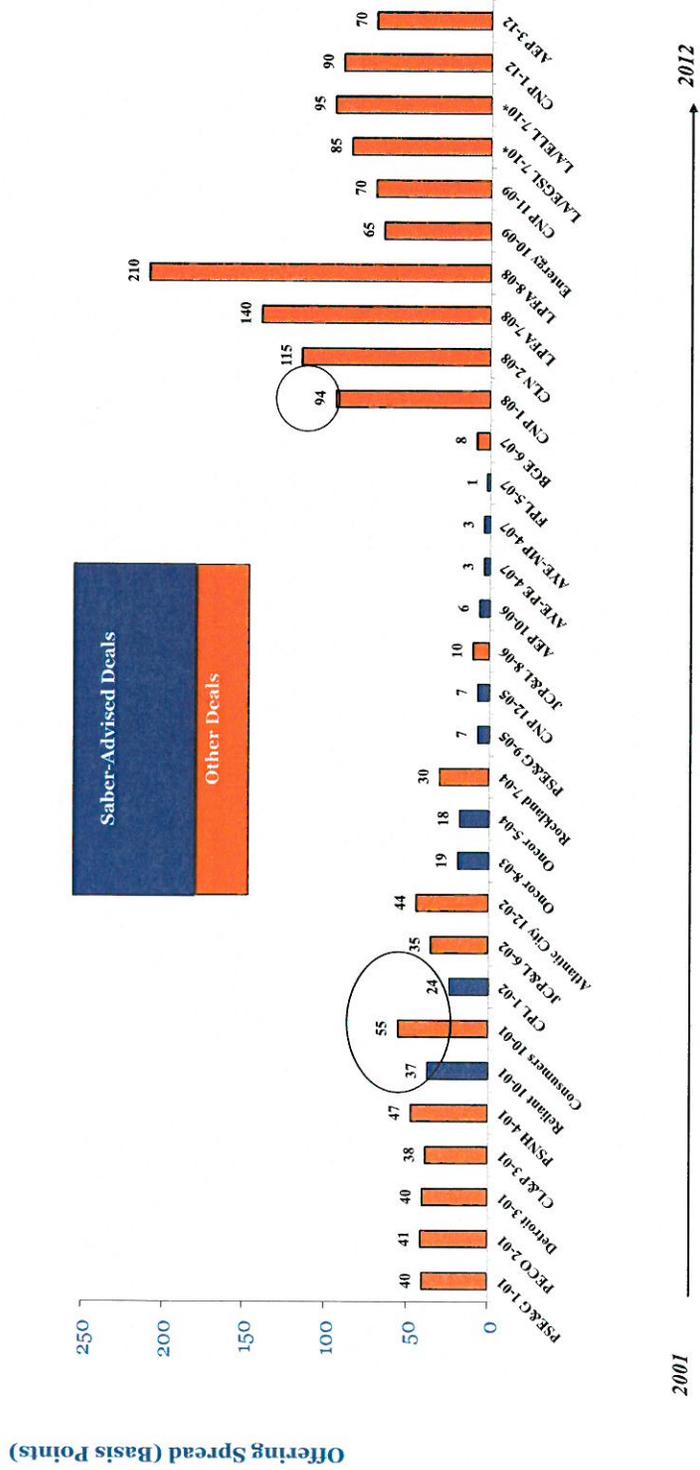
In connection with providing classification guidance, the SEC Staff also concluded that regulatory **assets** are not **financial assets**. This is supported by ASC Topic 860-55-8, *Transfers and Servicing*, and SFAS No. 166, *Accounting for Transfers of Financial Assets—an Amendment of FASB No. 140*-FASB Statement Appendix C paragraph 6. Further, the legislation that provides for the securitization of regulatory **assets** simply allows the utility's regulator to impose a surcharge or tariff on electricity sold in the future. The law, however, does not transpose regulatory **assets** into **financial assets**. The basis for the SEC Staff's conclusion is that the resulting law creates an enforceable right (which is a right imposed on one party by another, such as a property tax) and not a contractual right. The SEC Staff, after consulting with the FASB Staff, concluded that the FASB specifically limited **financial assets** to a contractual right, which is essentially a subset of an enforceable right. Thus, enforceable rights that are not contractual rights do not meet the definition of a **financial asset** under ASC Topic 860-55-8. However, beneficial interests in a securitization trust that holds nonfinancial **assets**, such as securitized **stranded costs**, would be considered **financial**

**New Issue Pricing Spreads to the Benchmark Swap Rate
 Utility AAA Securitization Deals 2001 to 2012
 4-6 Year Average Life**



* Taxable Munis

**New Issue Pricing Spreads to the Benchmark Swap Rate
 Utility AAA Securitization Deals - 2001 to 2012
 9-10 Year Average Life**



* Taxable Munis

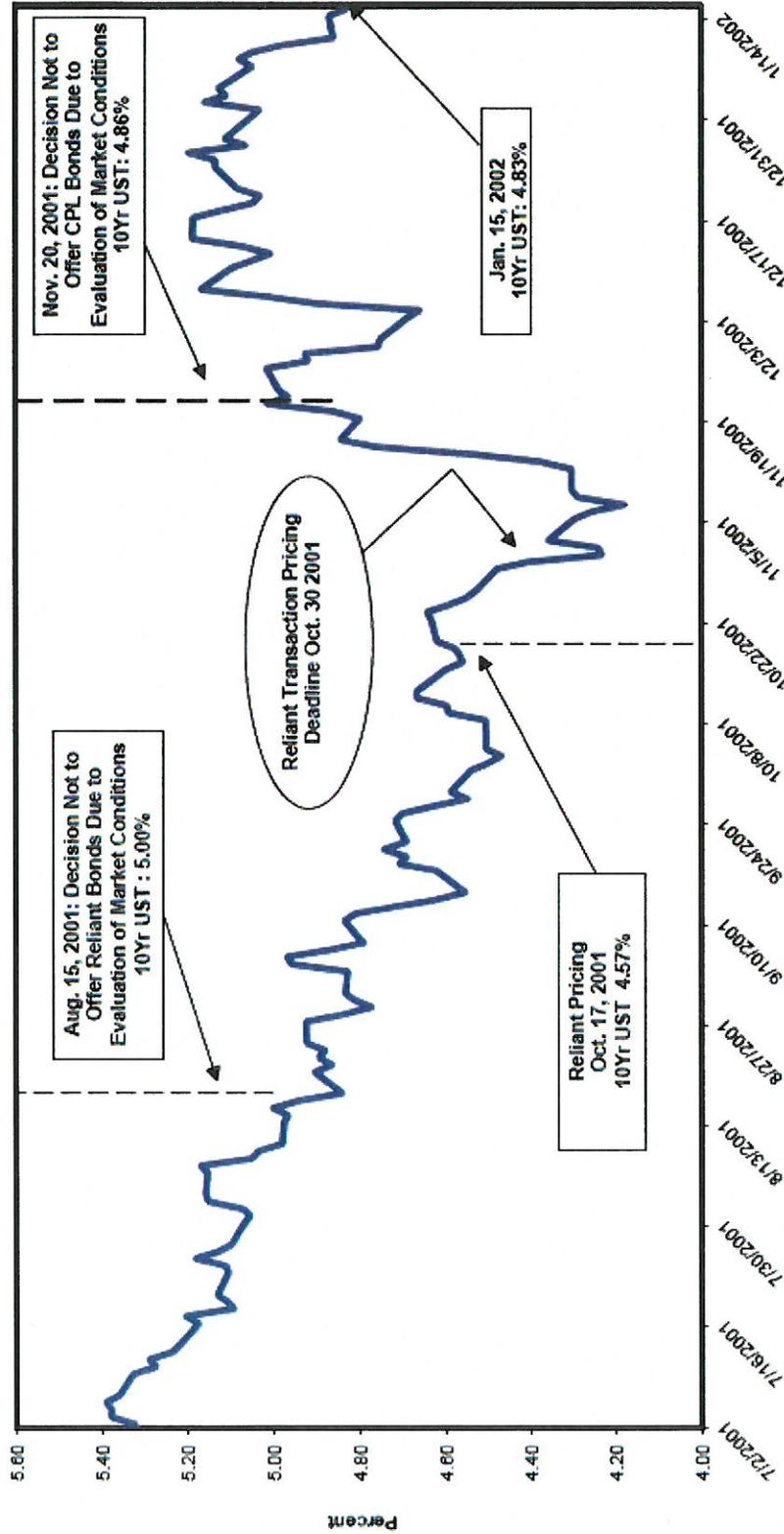

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TRANSACTION UPDATE

January 16, 2002

10-Year US Treasury Yields



Source: Bear Stearns, Bloomberg

Reliant Energy Pricing Summary

Issuer: Reliant Energy Transition Bond Company LLC
Amount: \$749 million
Pricing Date: October 17, 2001
Bond Ratings: AAA/Aaa/AAA

Class	Size (MM)	Average Life (yrs)	Benchmark Rate (%)	Spread Over Benchmark Rate (bps)	Yield (%)
A-1	\$ 115.00	2.71	3.683%	+16	3.843%
A-2	\$ 118.00	5.19	4.764%	+17	4.764%
A-3	\$ 130.00	7.19	5.169%	+22	5.169%
A-4	\$ 385.90	10.29	5.639%	+37	5.639%
Total	\$ 748.90				

As of pricing date, 5.639% Yield was lowest of all RRBs issued since 1997

Source: Bear Stearns

Landmark Pricing

- Reliant spreads to UST lowest of all 2001 RRB deals
- At 0 to 5 basis points, Salomon Brothers Research Dept. also notes “[Reliant] achieved the tightest spreads relative to [credit card ABS]^{1/} -- the most relevant RRB benchmark
- Careful market evaluation and judicious timing prevented “rush to market”

Decision to “time the market” estimated to have saved Reliant ratepayers approximately \$8-10 million (PV)

^{1/} See Salomon Smith Barney, *Stranded Asset Securitization Roundup*, Jan. 9, 2002.

Source: Bear Stearns

Pricing Comparison

Reliant Energy vs. Consumers Power

- Spreads 15-20 basis points lower than comparable Consumers bonds priced just 3 weeks later:

Reliant Energy Consumers Power

Pricing Date: 10/17/01

Pricing Date: 11/8/01

Average Life (yrs)	Spread Over Benchmark (bps)
2.71	+16
5.19	+17
7.19	+22
10.29	+37

Average Life (yrs)	Spread Over Benchmark (bps)
1	+30
3.00	+33
5.00	+36
7.00	+40
10.00	+55
12.85	+65

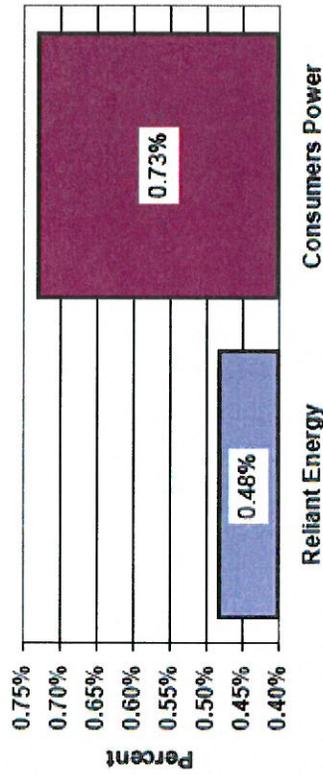
Approximate Reliant Savings (bps)
17
19
18
18

Compared to Consumers, narrower spreads saved Reliant ratepayers an additional estimated \$7-9 million (PV)

Substantial Underwriting Fee Savings Reliant Energy vs. Consumers Power

- Reliant paid significantly lower underwriting discounts/commissions than Consumers -- only 0.48% versus 0.73% (on weighted average basis)

Weighted Average Underwriting Fees



- Reliant also compares well to other 2001 RRB deals (See Appendix)
- Separate negotiations with each underwriter instrumental in keeping fees down

Source: Bear Stearns

Key Success Factors

- Strong continuing oversight:
 - Ensured all submitted costs complied with Commission “ceilings, not floors” directive
 - Optimized bond structure and credit enhancement to improve pricing
 - Coordinated strategic marketing plan -- competition among underwriters
 - Required lead underwriter to certify “lowest cost of funds” obtained
 - Continuing evaluation of market conditions enabled ratepayers to avoid weak markets and “rush to market” by underwriters/company regardless of cost

Key Success Factors (cont'd)

- Extensive marketing effort ensured strong investor competition
 - All classes sold to wide investor range
 - New investors brought to asset class
 - Secondary market trading remained strong
- Competitive selection of, and individual negotiations with, co-managers with RRB experience enabled more accurate price guidance, wider distribution and better execution

Key Concessions Secured by Commission/Saber To Protect Ratepayers

- **Underwriters:** Lead manager required to certify "lowest transition bond charges" in fact achieved
- **Reliant, as Servicer:**
 - Fee fixed at 0.05% of original principal amount; cannot retain transition charge "float"
 - Must use own resources to pay all servicing costs (including fees associated with legal challenges & other claims)
 - Cannot resign without prior Commission approval
- **Reliant:** Indemnify Commission for own negligence in all capacities
- **Commission:** Won right to disapprove any subsequent amendments to deal documents

Total value of ratepayer benefits from these changes could easily exceed \$2-4 million over life of bonds

CP&L Consistent Approach to Achieve Similar Result

- Continuously evaluate market conditions – high volatility, uncertainty
 - Manage volatility and risk
 - Ensure comprehensive marketing plan to broaden competition among investors for the bonds
 - Bring new investors to the security
 - Oversee and negotiate with underwriters for lowest cost of funds
- Provide Commission with Saber’s formal investment banking opinion confirming compliance with “lowest transition bond charges consistent with market conditions”

Selected Upcoming Data Releases

Monday	Tuesday	Wednesday	Thursday	Friday
		16-Jan CPI (Dec) Bus. Inventories (Nov) Ind. Production (Dec) Cap. Utilization (Dec)	17-Jan Housing Starts (Dec) Jobless Claims - 1/12	18-Jan
21-Jan HOLIDAY	22-Jan Leading Indicators (Dec)	23-Jan	24-Jan Jobless Claims - 1/17	25-Jan Existing Home Sales (Dec)
28-Jan New Home Sales (Dec)	29-Jan Cons. Confidence (Jan) FOMC Meeting	30-Jan GDP (Q4) FOMC Meeting	31-Jan Personal Income (Dec) Cons. Spending (Dec) Employment Costs (Q4) Jobless Claims - 1/17	1-Feb Unemployment Rate (Jan) Avg. Hrlly. Earnings (Jan) ISM (NAPM) Index (Jan)

- Upcoming FOMC meeting is key economic pricing risk for ratepayers

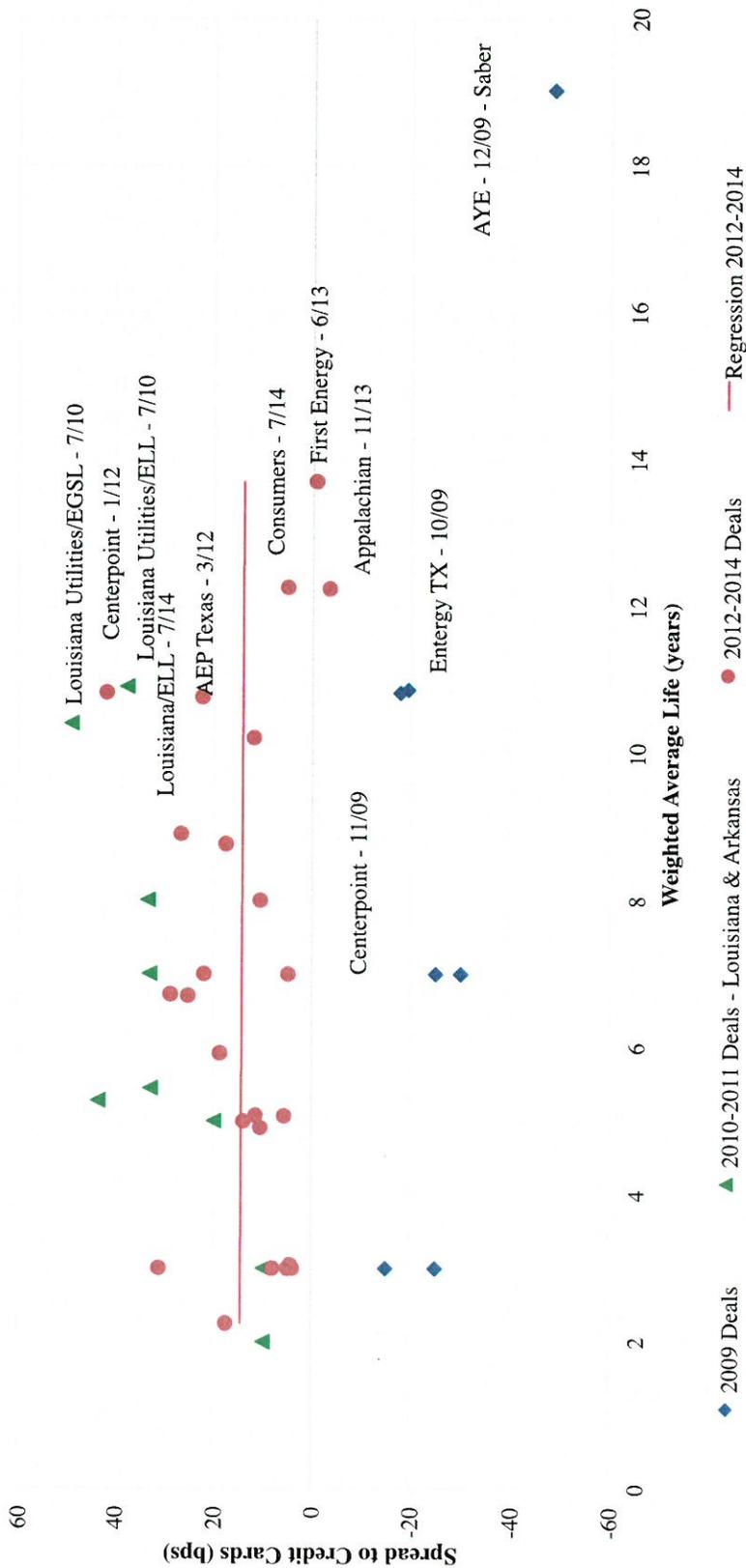
APPENDIX

2001 RRB Issuances

Transaction (Date)	Classes	Size (MM)	Average Life	Benchmark Rate	Pricing Spread	Underwriting Discounts and Commissions
Reliant Energy Transition Bond Co. LLC (10/18/01)	A-1	\$ 115.00	2.71	3.663%	+16	0.35000%
	A-2	\$ 115.00	5.19	4.764%	+17	0.43000%
	A-3	\$ 130.00	7.19	5.169%	+22	0.49000%
	A-4	\$ 385.90	10.29	5.639%	+37	0.53500%
	Total	\$ 748.90			Wtd. Average:	0.49224%
Consumers Funding LLC, Series 2001-1 (11/8/2001)	A-1	\$ 26.00	1.00	2.292%	+30	0.37000%
	A-2	\$ 84.00	3.00	3.483%	+33	0.46200%
	A-3	\$ 31.00	5.00	4.218%	+36	0.66200%
	A-4	\$ 95.00	7.00	4.610%	+40	0.78200%
	A-4	\$ 117.00	10.00	4.914%	+55	0.81700%
	Total	\$ 468.59			Wtd. Average:	0.73095%
PSNH Funding LLC (4/20/01)	A-1	\$ 75.21	1.09	4.402%	+20	0.20757%
	A-2	\$ 214.65	5.04	5.531%	+25	0.37500%
	A-3	\$ 235.14	9.99	6.064%	+47	0.50000%
	Total	\$ 525.00			Wtd. Average:	0.40700%
CT RRB Transaction CL&P-1 (3/27/01)	A-1	\$ 224.86	1.16	4.741%	+15	0.30539%
	A-2	\$ 255.06	3.16	5.238%	+16	0.34000%
	A-3	\$ 292.38	5.16	5.560%	+21	0.40000%
	A-4	\$ 287.91	7.02	3 MTH LIBOR	+31	0.43000%
	A-5	\$ 378.20	8.89	5.878%	+38	0.50000%
Total	\$ 1,438.40			Wtd. Average:	0.40697%	
Detroit Edison Securitization Funding LLC (3/2/01)	A-1	\$ 124.54	1.49	5.041%	+14	0.35000%
	A-2	\$ 179.04	3.26	5.343%	+17	0.40000%
	A-3	\$ 322.79	5.79	5.608%	+28	0.45000%
	A-4	\$ 405.72	8.79	5.792%	+40	0.50000%
	A-5	\$ 326.24	11.26	5.864%	+54	0.55000%
	A-6	\$ 390.67	13.26	5.952%	+67	0.62500%
Total	\$ 1,750.00			Wtd. Average:	0.50710%	
PSE&G Transition Funding LLC (1/25/01)	A-1	\$ 105.25	1.00	5.337%	+12.5	0.35000%
	A-2	\$ 368.98	2.90	5.611%	+16	0.40000%
	A-3	\$ 182.62	4.88	5.612%	+21	0.45000%
	A-4	\$ 496.61	7.02	3 MTH LIBOR	+30	0.50000%
	A-5	\$ 328.03	9.38	6.099%	+40	0.50000%
	A-6	\$ 453.56	11.39	6.161%	+50	0.55000%
	A-7	\$ 219.69	12.99	6.209%	+60	0.60000%
	A-8	\$ 370.26	14.27	6.247%	+70	0.65000%
Total	\$ 2,525.00			Wtd. Average:	0.51520%	

Source: Bear Stearns; Bloomberg

**AAA Utility Securitization Spreads to AAA Credit Cards
 by Tranche (1)
 2009 to 2014**



Note: Spreads to credit cards are interpolated for WAL<10 years and extrapolated for WAL> 10 years.
 Source: JP Morgan ABS Global Weekly Market Report, closest to pricing date (0-3 days)
 (1) Includes 41 tranches from 18 utility securitization transactions

July 17, 2013

Structured Products Research

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ABSolute Value: Rate Reduction Bond ABS Primer An Overview of Utility Receivables Securitization

Executive Summary

- Securitizations of utility receivables have been known by several names: stranded-asset, rate-reduction and storm-recovery bonds. The market convention is to refer to all bonds in this sector as rate-reduction bonds or RRBs. We follow that convention in this report, which surveys the structural features of and conditions in the market for RRBs.
- RRBs are securitizations backed by the future collections of special charges applied to electric utility bills. The amount of the collection is based on power usage, which can vary from year to year based on weather or economic conditions.
- The bonds issued in this sector are structured with robust legal and regulatory protections to mitigate the potential political risks that may stem from the introduction of the utility tariff on ratepayer bills.
- Internal credit enhancement tends to be relatively low compared to benchmark consumer ABS due to these legal safeguards as well as the presence of the “true-up mechanism.” This procedure allows the utility tariff to be adjusted, either up or down, in the event that tariff collections are significantly different than what would be needed to meet the scheduled amortization of the bonds. It has been used successfully in several cases.
- RRB issuance has been relatively light in recent years, although outstanding bonds stood at \$11.3 billion as of Q2 2013 due to the relatively long average lives of the bonds. RRBs repay principal based on a scheduled amortization, which limits the prepayment risk and may make payments quarterly or semiannually, similar to corporate bonds.
- RRBs have similarities to secured utility bonds, such as first-mortgage bonds, and have found an audience from corporate crossover buyers, in our opinion. However, RRBs have significant legal and regulatory protections not normally found in corporate bonds.
- In our opinion, RRBs offer some of the best relative value in the consumer ABS market for the credit risk taken. Spreads of rate-reduction bond ABS have remained relatively wide throughout the post-crisis period. RRB spreads that trade at +4 bps or more to benchmark credit card ABS represent better relative value opportunities, in our opinion.

Table of Contents

Utility Receivables – What’s in a Name?
Page 2

Issuance and Outstanding
Pages 2 - 3

RRB Deals and Sponsors
Page 4

Relative Value Analysis to Benchmark Cards
Pages 5 - 6

Structural Considerations
Page 7

A Regulatory Future Flow Receivable – Page 7

Irrevocability and State Pledge – Page 7

Nonbypassability – Page 8

Bankruptcy Remoteness
Page 8

True-Up Mechanism
Page 8

Credit Analysis
Page 8

Customer Base – Page 9

Usage Patterns – Page 9

Size of Utility Tariff
Page 9

Please see the disclosure appendix of this publication for certification and disclosure information.
All estimates/forecasts are as of 07/17/13 unless otherwise stated.

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Together we'll go far



Utility Receivables – What’s in a Name?

Rate-reduction bond ABS are securitizations backed by the future collections of special charges applied to electric utility bills. The amount of the collection is based on power usage. These utility receivables deals have been identified by different names since first coming on the ABS scene in 1997. The earliest deals were called “stranded assets” because the charges applied to ratepayer bills were meant to defray the costs of nuclear power plants that would no longer be economic in a deregulated power-generation market. The investments were economically “stranded” under the previous regulatory regime and could not be recovered under ordinary market conditions.

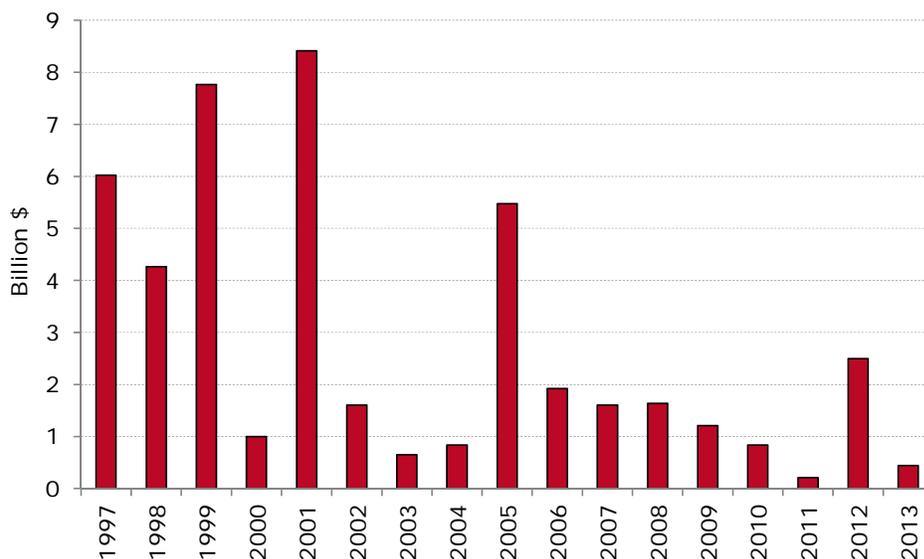
Later deals were termed “rate-reduction” bonds because electric utilities were allowed to recover the costs of certain infrastructure investments and, in turn, pass along lower utility rates to customers. Again, a deregulated power-generation market was intended to bring lower costs to end users. More recent deals have been christened “storm-recovery” bonds because utilities in various states have been allowed to apply a surcharge to bills to help pay for reconstruction and repairs to power networks damaged by hurricanes or other storms.

Despite the different names and reasons for implementation of the utility tariffs, the structural features and credit protections are generally the same. The market convention is to refer to all bonds in this sector *rate-reduction bonds*, or RRBs. We follow that convention in this report, which surveys the structural features of and conditions in the market for RRBs.

Issuance and Outstanding

The amount of RRB issuance in the early years was substantial, and many market participants expected considerable upside from the sector. Indeed, \$27.5 billion of RRBs were issued in the five years from 1997–2001. However, in the following 12 years, including YTD 2013, the market has averaged just \$1.6 billion per year, and only 2005 exceeded \$5 billion (Exhibit 1). RRBs have become a smaller niche sector than many would have anticipated, but we believe RRBs offer certain characteristics that may not be found in other ABS sectors.

Exhibit 1: Rate Reduction Bond ABS Issuance



Source: Asset-Backed Alert, Bloomberg, Wells Fargo Securities, LLC.

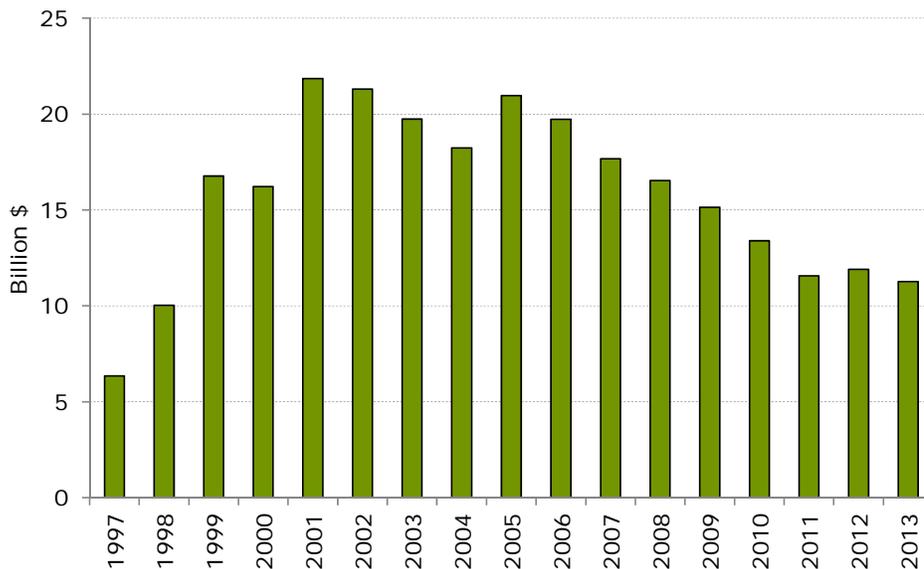
**ABSolute Value: Rate Reduction Bond ABS Primer
July 17, 2013**

**WELLS FARGO SECURITIES, LLC
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RRBs repay principal based on a scheduled amortization, which limits the prepayment risk found in many other ABS backed by consumer receivables. Furthermore, the bonds may pay interest and principal quarterly or semiannually, similar to corporate bonds. This feature is one reason that RRBs have found an audience from corporate crossover buyers, in our opinion. RRBs have similarities to secured utility bonds such as first-mortgage bonds.

However, RRBs have significant legal and regulatory protections not normally found in a secured corporate bond. In addition, RRBs, in most cases, offer longer average lives than the typical auto or credit card ABS, with many bonds reaching seven years or more. Bonds with average lives of 10 years or more are not unusual. The longer average lives, combined with fixed-rate coupons offer ABS investors access to longer duration bonds.

Exhibit 2: RRB ABS Outstanding



Source: SIFMA.

Those longer principal windows and average lives are the reasons that the amount of RRBs outstanding is much higher than might have been expected given the dearth of new-issue volume over the past few years. Total RRBs outstanding fell to the \$11 billion–\$12 billion range from 2011–2013 from the most recent peak of \$21 billion in 2005 (Exhibit 2). The RRB sector accounted for about 2% of total consumer ABS outstanding as of Q2 2013. A modest amount of issuance should keep the amount of ABS backed by utility receivables stable.

However, it can be difficult to forecast new-issue volume of RRBs because of the long legislative and regulatory lead times required to complete these deals. The utilities may also find it more advantageous to issue corporate debt instead of ABS. The history of RRB deals and their utility sponsors are listed in Exhibit 3. Deal sizes averaged approximately \$1.1 billion from 1997–2005, but declined to \$575 million after 2005. This average amount was boosted by two deals that weighed in at \$1.7 billion each. Excluding those two deals, the average deal size since 2005 has been \$433 million.

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Exhibit 3: Rate Reduction Bond ABS Deals and Utility Sponsors

Deal Name	Pricing Date	Original Balance (MM\$)	Trust Name	Utility Sponsor
CIPGE 1997-1	11/25/97	2,901	California Infrastructure PG&E	Pacific Gas and Electric Company
CISDG 1997-1	12/4/97	658	California Infrastructure SDG&E	San Diego Gas and Electric Company
CISCE 1997-1	12/4/97	2,463	California Infrastructure SCE	Southern California Edison Company
COMED 1998-1	12/7/98	3,400	COMED Transitional Funding Trust	Commonwealth Edison Company
IPSPT 1998-1	12/10/98	864	Illinois Power Special Purpose Trust	Illinois Power Company
PECO 1999-A	3/18/99	4,000	Peco Energy Transition Trust	Peco Energy Company
SPPC 1999-1	3/30/99	24	Sierra Pacific Power Company	Sierra Pacific Power Company
BECO 1999-1	7/14/99	725	Massachusetts RRB Special Purpose Trust	Boston Edison Company
PPL 1999-1	7/29/99	2,420	PP&L Transition Bond Company LLC	PPL Electric Utilities Corp.
WPP 1999-A	11/3/99	600	West Penn Funding LLC Transition Bonds	West Penn Power
PECO 2000-A	4/27/00	1,000	Peco Energy Transition Trust	Peco Energy Company
PEGTF 2001-1	1/25/01	2,525	PSE&G Transition Funding LLC	Public Service Electric & Gas Co.
PECO 2001-A	2/15/01	805	Peco Energy Transition Trust	Peco Energy Co
DESF 2001-1	3/2/01	1,750	Detroit Edison Securitization Funding LLC	Detroit Edison Company
CTRRB 2001-1	3/27/01	1,438	Connecticut RRB Special Purpose Trust	Connecticut Light & Power
PSNH 2001-1	4/20/01	525	Public Service New Hampshire Funding LLC	Public Service Company of New Hampshire
WMECO 2001-1	5/14/01	155	Massachusetts RRB Special Purpose Trust	Western Massachusetts Electric Company
CNP 2001-1	10/17/01	749	CenterPoint Energy Transition Bond Company IV	CenterPoint Energy Houston Electric LLC
CONFD 2001-1	10/31/01	469	Consumers Funding LLC	Consumers Energy Co
PSNH 2002-1	1/16/02	50	Public Service New Hampshire Funding LLC	Public Service Company of New Hampshire
AEPTC 2002-1	1/31/02	797	AEP Texas Central Transition Funding	Central Power and Light Company
JCPL 2002-A	6/4/02	320	JCP&L Transition Funding LLC	Jersey Central Power & Light
ACETF 2002-1	12/11/02	440	Atlantic City Electric Transition Funding LLC	Atlantic City Electric Company
ONCOR 2003-1	8/14/03	500	Oncor Electric Delivery Transition Bond LLC	Oncor Electric Delivery Co.
ACETF 2003-1	12/18/03	152	Atlantic City Electric Transition Funding LLC	Atlantic City Electric Company
ONCOR 2004-1	5/28/04	790	Oncor Electric Delivery Transition Bond LLC	Oncor Electric Delivery Co.
RCTF 2004-1A	7/28/04	46	Rockland Electric Co Transition Funding LLC	Orange and Rockland Utilities, Inc.
PERF 2005-1	2/3/05	1,888	PG&E Energy Recovery Funding LLC	Pacific Gas & Electric Co.
BECO 2005-1	2/15/05	675	Massachusetts RRB Special Purpose Trust	Boston Edison Co.; Commonwealth Electric Co.
PEGTF 2005-1	9/9/05	103	PSE&G Transition Funding LLC	Public Service Electric and Gas Co.
WPP 2005-A	9/22/05	115	West Penn Funding LLC Transition Bonds	West Penn Power
PERF 2005-2	11/9/05	844	PG&E Energy Recovery Funding L	Pacific Gas & Electric Co
CNP 2005-A	12/9/05	1,851	CenterPoint Energy Transition Bond Company IV	CenterPoint Energy
JCPL 2006-A	8/4/06	182	JCP&L Transition Funding LLC	Jersey Central Power & Light
AEPTC 2006-A	9/26/06	1,740	AEP Texas Central Transition Funding	AEP Texas Central Co.
FPL 2007-A	5/17/07	652	FPL Recovery Funding LLC	Florida Power & Light Co
EGSI 2007-A	6/22/07	330	Entergy Gulf States Reconstruction Funding LLC	Entergy Texas Inc
RSBBC 2007-A	6/29/07	623	RSB Bondco LLC	Baltimore Gas & Electric Co
CNP 2008-A	1/29/08	488	CenterPoint Energy Transition Bond Company IV	CenterPoint Energy
CLECO 2008-A	2/28/08	181	Cleco Katrina/Rita Hurricane Recovery Funding LLC	Cleco Power LLC
LPFA 2008-ELL	7/22/08	688	Louisiana Utilities Restoration Corp./ELL	Entergy Louisiana LLC
LPFA 2008-EGSL	8/20/08	278	Louisiana Utilities Restoration Corp./EGSL	Entergy Gulf States Louisiana
ETI 2009-A	10/29/09	546	Entergy Texas Restoration Funding LLC	Entergy Texas Inc
CNP 2009-1	11/18/09	665	CenterPoint Energy Transition Bond Company IV	CenterPoint Energy
LCDA 2010-EGSL	7/16/10	244	Louisiana Local Gov't Environmental Facilities and Community Development Authority	Entergy Gulf States Louisiana
LCDA 2010-ELL	7/16/10	469	Louisiana Local Gov't Environmental Facilities and Community Development Authority	Entergy Louisiana LLC
EAI 2010-A	8/11/10	124	Entergy Arkansas Restoration F	Entergy Arkansas Inc
ELL 2011-A	9/15/11	207	Entergy Louisiana Investment R	Entergy Louisiana LLC
CNP 2012-1	1/11/12	1,695	CenterPoint Energy Transition Bond Company IV	CenterPoint Energy
AEPTC 2012-1	3/7/12	800	AEP Texas Central Transition Funding	AEP Texas Central Co.
FEOH 2013-1	6/12/13	445	FirstEnergy Ohio PIRB Special Purpose Trust	FirstEnergy Corp.

Source: Asset-Backed Alert, Bloomberg, Wells Fargo Securities, LLC.

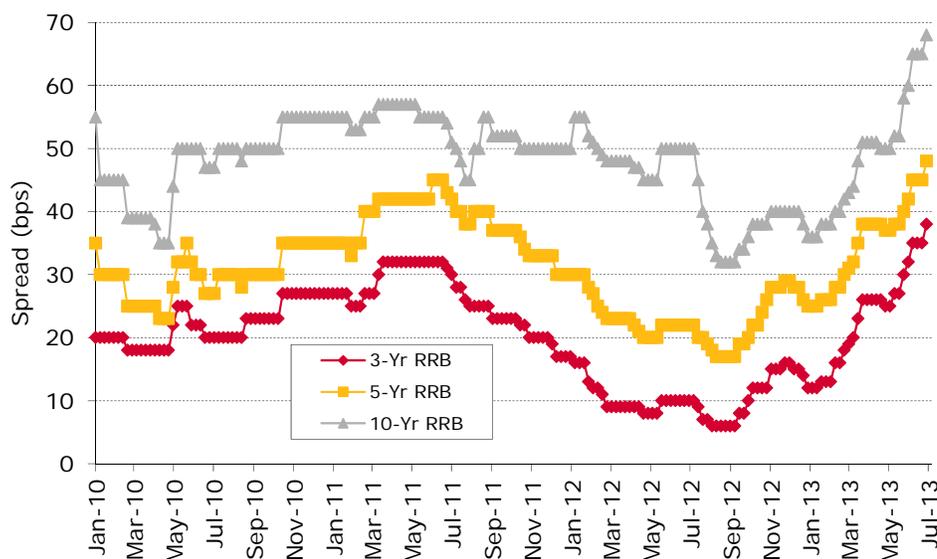
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Relative Value Analysis to Benchmark Cards

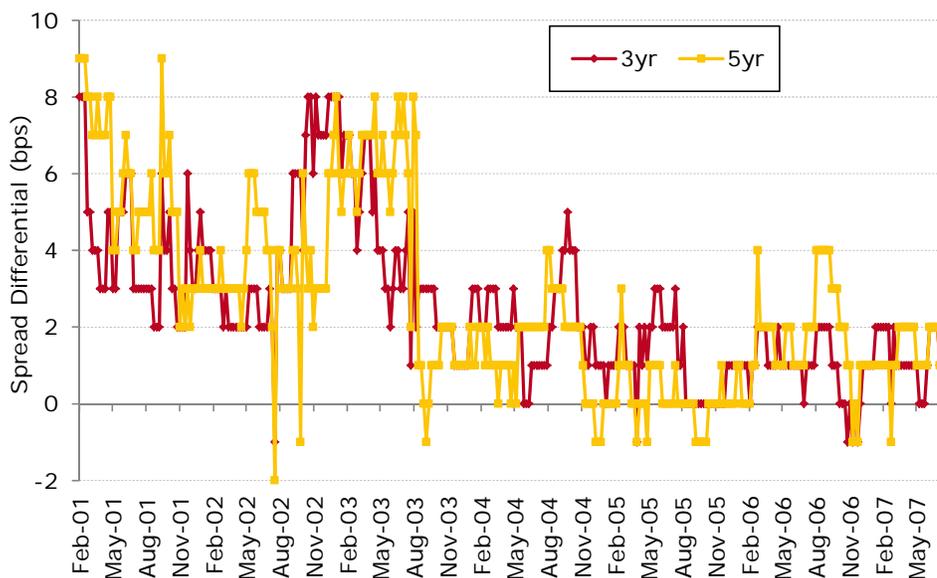
Spreads of rate-reduction bond ABS have remained relatively wide throughout the post-crisis period and have exhibited some wide swings over the past few years. Since hitting their post-crisis lows in September 2012, spreads have widened by about 30 bps through July 12, 2013 (Exhibit 4). We believe that this trend has been influenced by a general widening of spreads in the ABS market during 2012, and increased volatility brought on by the market's reaction to Federal Reserve policy communications. In our opinion, RRBs offer some of the best relative value in the consumer ABS market for the credit risk taken.

Exhibit 4: RRB Spreads



Source: Wells Fargo Securities, LLC.

Exhibit 5: RRB / Credit Card ABS Spread Differential – 2001-2007

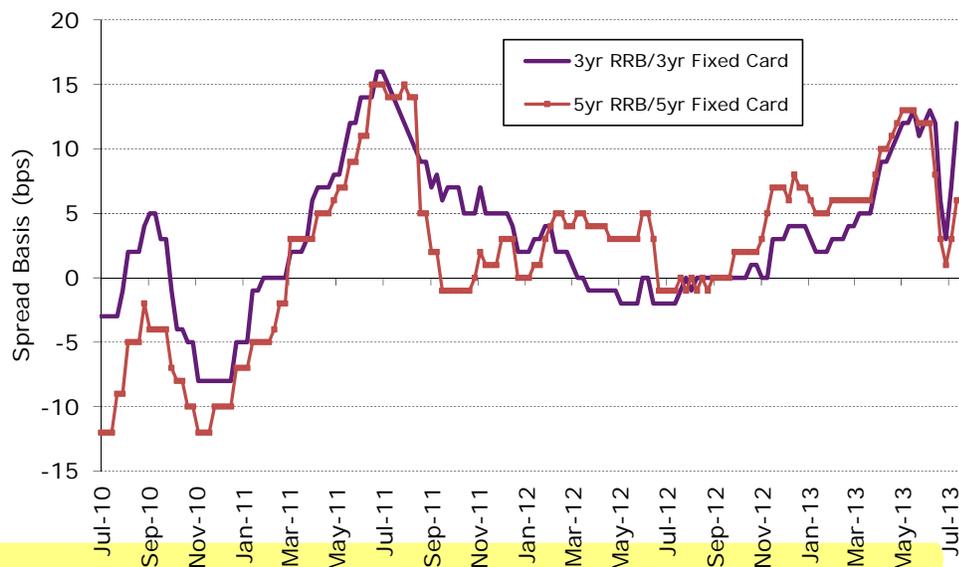


Source: Wells Fargo Securities, LLC.

Wells Fargo Securities has collected generic spreads on the RRB sector back to 2001. In our opinion, assessing relative value in rate-reduction bond ABS can be best accomplished by reviewing the spread differential between RRBs and benchmark credit card ABS. This relationship from 2001 to just before the market dislocation in July 2007 is charted in Exhibit 5. The average weekly difference was +4 bps to +6 bps, depending on the tenor of the bonds from 2001 to June 2003. However, the range of the spread differential was a wider +2 bps to +9 bps for three-year and five-year average life bonds.

After June 2003, the spread differential narrowed to an average weekly level of just about +1 bp, and this difference was stable across the benchmark tenors in RRBs (three-year, five-year and 10-year average lives). We believe that an increase in the amount of bonds outstanding and the number of issuers, as well as increasing investor acceptance, helped push the spread differential tighter. The week-to-week variability was relatively low, and this pattern was consistent with the benchmark auto and credit card ABS sectors. It indicated a meaningful increase in transparency and liquidity, in our view.

Exhibit 6: RRB / Credit Card ABS Spread Differential – 2010-2013



Source: Wells Fargo Securities, LLC.

RRBs traded well inside credit card ABS during the depths of the financial crisis in late 2008 and early 2009 (spreads 200 bps–300 bps inside) because investors placed a higher risk premium on large commercial banks and their credit card portfolios during this period. However, it took almost another two years for the spread relationship to normalize by early 2011.

The average weekly spread differential has returned to pre-crisis levels of +2 bps to +3 bps from July 2010 to July 2013. The average is closer to +4 bps, though, if all of 2010 is excluded. Nevertheless, secondary trading levels for RRBs have experienced large excursions away from this long-run average level, and these excursions have had a tendency to persist for a number of weeks.

We view RRB spreads trading at +4 bps or more to benchmark credit card ABS as representing better relative value. In general, RRBs involve less credit risk than credit card ABS, although the smaller size of the RRB sector, wider principal payment windows and somewhat less transparency due to the regulatory nature of the collateral require some spread concession, in our view.

Structural Considerations

Unlike most asset-backed securities, rate-reduction bond ABS are characterized primarily by their legal and regulatory framework. To a large extent, the credit analysis of the underlying obligors, which are the ratepayers in the utility's service area, is a secondary consideration, in our view. The securitization structure of most RRBs is relatively straightforward. The utility would transfer its ownership of the utility charges to a bankruptcy-remote special purpose vehicle (SPV) that would issue the ABS to investors.

The ABS may be issued as a single pass-through security, or there may be several tranches of bonds issued that pay in sequential order. Principal is repaid according to a scheduled amortization that would be consistent with the forecast for power usage and cash flows. Interest payments may be made quarterly or semiannually. The cash flows are stressed in the rating process to determine how much forecast error the deal can withstand and still make payments to investors in a timely manner.

Credit enhancement is provided, in most cases, by a small amount (generally 0.5%–1%) of overcollateralization, reserve fund, or some form of capital account to provide liquidity in the event of short-run cash flow shortfalls. However, the primary form of credit enhancement is a regulatory-mandated "true-up mechanism" that can adjust the amount of the utility tariff charged to the customer. The robust legal and regulatory nature of the true-up mechanism, along with the fundamental character of power usage, allows for the relatively low level of internal credit enhancement in RRBs.

A Regulatory Future Flow Receivable

One of the key considerations in the RRB sector is that the asset securitized is a future flow rather than an existing loan or receivable. The utility tariff is established by a law passed by a state legislature and further put into practice by a financing order from the state's utility regulators. The charge added to the utility bill is established as a property right of the utility that can be transferred or sold and pledged as a security interest similar to other kinds of receivables securitized in the ABS market.

In the event that a utility is subject to a merger or files for bankruptcy, the order to collect the utility tariff remains in place with the successor utility. This provision helps avoid any disruption in billing and collections of the tariff and, therefore, for bondholders. Although the utility has a target amount to be raised from the utility tariff, the periodic amount of the cash flows can only be estimated at origination based on the expectations for usage. Actual utility usage and cash flows may deviate from the forecast amount.

Irrevocability and State Pledge

One of the key legal features of an RRB is that the utility tariff is *irrevocable*. As noted above, the receivables have been created by legal and regulatory actions and are collected over time based on electricity usage. The receivable does not already exist, unlike an auto loan or lease. There is a risk that a future legislature or regulator could act to alter or rescind the utility tariff. In order to mitigate this risk, there is irrevocability language inserted in the legislation to prevent the impairment of the value of the utility tariff without adequate compensation.

The RRBs are not obligations of the state, nor do they carry the full faith and credit of any government or agency. However, the legislation creating the utility tariffs will generally contain a *state pledge* not to limit, alter, or impair the property rights created. There may be challenges from other constituencies over time that oppose the creation of the utility tariff, either through new legislation or ballot initiatives. The state pledges not to make any changes to the law or regulatory environment until the bonds are paid in full to mitigate the potential political risks to an asset created through the political process.

Non-bypassability

The utility receivables generated would be collected based on a customer's usage and the fact that the customer is connected to the utility's deliver system. This delivery, or network, charge should not be avoided, or bypassed, just because a customer contracts with another generator of the power. The utility can collect the charges from existing customers as well as future customers from its service area.

In some states or markets, third-party energy providers may be allowed by regulators to bill customers directly. In these cases, the tariff is collected by the third-party provider and the charges are passed along to the utility. Customers can reduce their exposure to the charge by using less power, or by disconnecting from the service grid entirely. However, they should not be able to avoid paying the utility tariff as long as they are connected to the utility's network.

Bankruptcy Remoteness

Like other types of securitized assets, the utility tariff is established as a property right that can be sold or transferred to another party. The right to the future receivables is sold by the utility to a bankruptcy-remote special purpose vehicle (SPV), which is the issuer of the ABS. This "true sale" of the receivables to the SPV should isolate the payments from being consolidated with the utility in the event that it files for bankruptcy.

The transfer of the utility tariff is a sale, not a pledge or a secured financing. Legal counsel would normally provide a nonconsolidation opinion that a bankruptcy court would not consolidate the SPV with the bankruptcy estate of the utility. This bankruptcy-remote nature of ABS is the standard in the market to provide a separation between the ABS and any potential bankruptcy of the seller/servicer.

True-Up Mechanism

The key credit enhancement feature of RRB deals is the true-up mechanism. This procedure allows the utility tariff to be adjusted, either up or down, in the event that tariff collections are significantly different than what would be needed to meet the scheduled amortization of the bonds, including any fees and replacement of credit-enhancement reserves. The true-up can occur at least annually, as needed, but some deals allow for more frequent changes in the charges, such as semiannually. Regulators cannot alter the true-up, nor do they need to approve its use.

The strength of the legal and structural safeguards, along with the robust nature of the protection provided by the true-up mechanism, affords substantial credit enhancement for ABS investors. Indeed, Fitch Ratings indicated in its "Outlook and Performance Review for U.S. Utility Tariff ABS" (Feb. 1, 2013) that several RRB transactions have successfully used their true-up mechanisms to offset revenue shortfalls.

Weather-related variations in collections have occurred due to system outages from hurricane damage and warmer-than-normal winter temperatures. In addition, six transactions suffered shortfalls from 2008–2010 due to the recession's effects on customers reducing their power usage. Some were residential customers trying to save on monthly expenses, whereas others were commercial and industrial customers cutting production or going out of business, according to the Fitch Ratings report.

Credit Analysis

When rating a new RRB deal and determining the potential variability in cash flows, the rating agencies typically perform a credit analysis of the utility and the service area that is subject to the utility tariff. The major areas of inquiry include the energy usage level and trends of the customer base and its composition, the size of the tariff in relation to the entire utility bill, customer

**ABSolute Value: Rate Reduction Bond ABS Primer
July 17, 2013**

**WELLS FARGO SECURITIES, LLC
STRUCTURED PRODUCTS RESEARCH**

delinquency and loss trends, national and local economic factors affecting energy usage, and seasonality due to weather conditions.

The rating agencies incorporate various stresses in their cash-flow models to take account of forecast errors or variations in usage based on changing credit conditions. Although the credit analysis of the utility, its customer base and servicer area are important, they tend to take a position of secondary importance, in our opinion, to the legal and regulatory structure of the utility tariffs and the ability to true-up the charges when collections vary from the forecast.

Customer Base

A utility's customer base typically can be divided into four segments: Residential, Commercial, Industrial, and Government. The most important segments tend to be Residential and Commercial/Industrial. Most service areas have a low concentration of government obligor exposure, although some areas may include state or federal government offices or military bases.

Residential customers offer the most diversification because each household is just a small portion of the overall pool of residential customers. They should also represent the most stable cash flows because households (and smaller commercial customers) tend to be less sensitive to economic cycles in their power usage. It could be assumed that new residents would replace those who move away, providing additional long-run stability. However, reduced demand for housing during recessions may present a potential risk to power usage and the generation of cash flows backing the RRBs.

Commercial and industrial customers are likely to be more concentrated as a group, and the size of individual firms could mean an increase in risk to cash flows in the event of reduced usage from less production, self-generation of power, or the possibility of ceasing business in that service area. For that reason, the rating agencies analyze the power-usage patterns of areas with cyclical industries and emphasize periods of recession in their analysis. This process provides an estimate of the potential variability of cash flows from the amortization schedule of the bonds.

Usage Patterns and Seasonality

Residential and smaller commercial customers normally show greater changes in power usage due to changes in weather patterns. An unusually hot summer or colder-than-normal winter would likely drive power demand higher, and these seasonal patterns tend to be more important for short-run variations in power usage. In the long run, conservation measures, increased use of energy-efficient appliances and technological advances are more likely to play a role in energy-usage patterns. Larger commercial and industrial customers would also be affected by these weather-related and technological advances, although in the near term, they tend to be affected more by fluctuations in economic activity.

Size of Utility Tariff

The rating agencies also consider the size of the utility tariff relative to the overall customer bill. This relationship becomes more important if the true-up mechanism must be used to increase the charge due to variability in the receivables generated. An increase in the overall price of power could be large enough to reduce demand for power if the tariff is a relatively large portion of the bill. This incentive may become particularly intense for larger industrial customers who have more energy alternatives.

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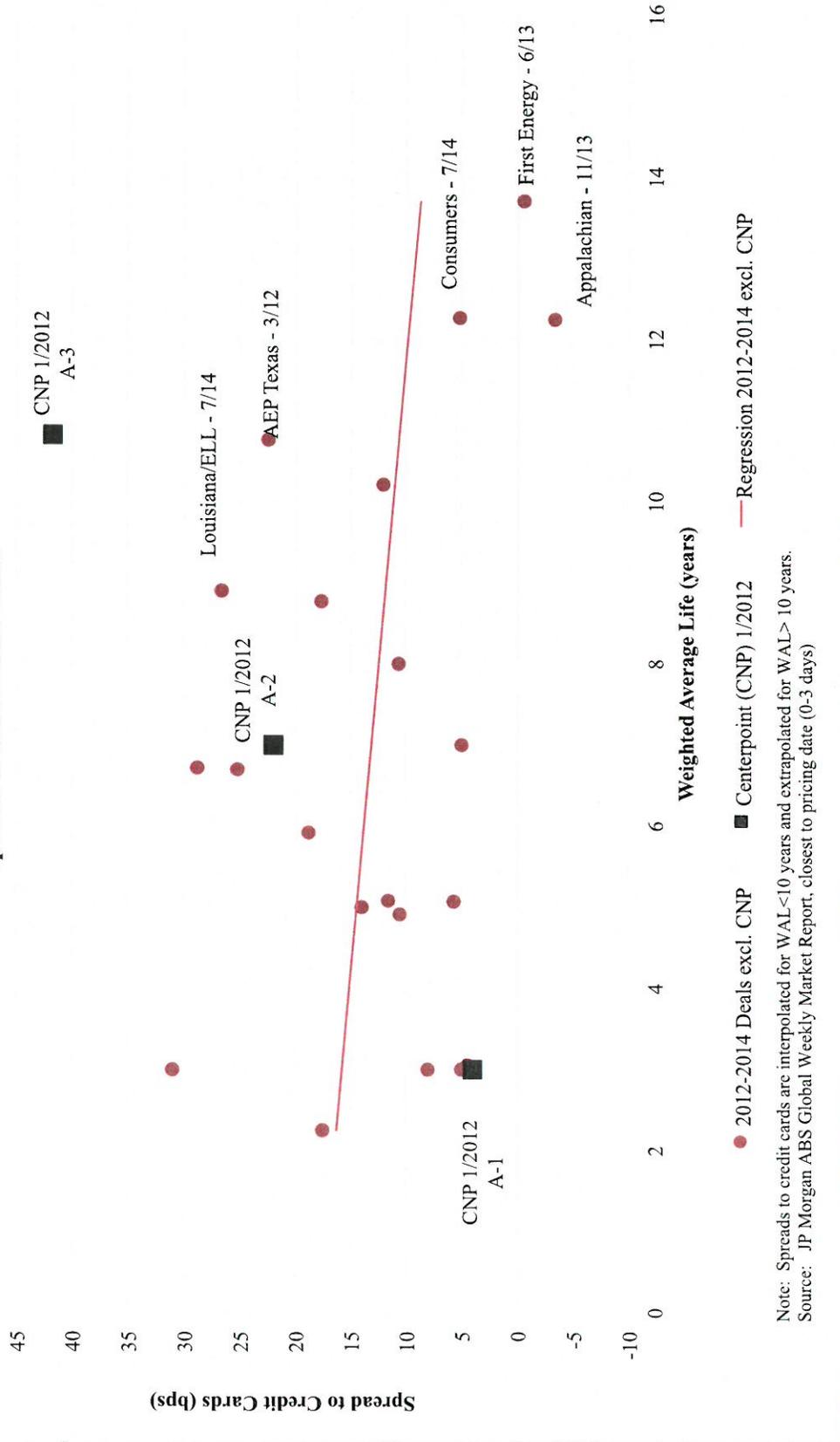
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**Centerpoint 1/11/2012 Securitization - 3 Tranches
 vs All Others 2012 to 2014
 Spreads to AAA Credit Cards**



Note: Spreads to credit cards are interpolated for WAL < 10 years and extrapolated for WAL > 10 years.
 Source: JP Morgan ABS Global Weekly Market Report, closest to pricing date (0-3 days)

CenterPoint Energy Houston Electric (CEHE) Securitization

On Jan. 29, 2008, CEHE priced one of the most successful asset-backed securities (ABS) offerings in many months, attracting both traditional asset-backed buyers and corporate "crossover" investors

CenterPoint Energy Transition Bond Company III, LLC (CEHE III)

Tranche	Balance	Coupon	Yield	Price	WAL	Spread to Swaps	Window (yrs)
A-1	\$301,427,000	4.182%	4.182%	99.96161%	5.00	\$ + 64 bp	Feb-2009 : Feb-2017
A-2	187,045,000	5.234%	5.234%	99.94074%	10.52	\$ + 94 bp	Feb-2017 : Feb-2020
	\$488,472,000		4.591%		7.11	Time Weighted Yield:	4.782%

Overview of CEHE III Offering

- The credit quality of utility securitization bonds came into sharp focus in today's environment of volatile credit markets and a weakening consumer
- We estimate that each tranche of the CEHE III offering priced approximately 15-25 bp inside of like-maturity credit card securities
- In fact, Citi priced a 10-year credit card transaction at +118 bp on Jan. 31, a premium of 24 bp to CEHE III's A-2 tranche

Precedent Texas Securitizations

Date	Utility	Size (\$mm)	WAL (yrs)	Time-Weighted Yield (%)
01/29/08	CenterPoint Energy Houston Electric III	\$488,472	7.11	4.782%
08/22/07	Entergy Gulf States	\$329,500	8.05	5.834%
10/04/06	AEP Texas Central	\$1,739,700	8.44	5.192%
12/09/05	CenterPoint Energy Houston Electric II	\$1,851,000	8.26	5.177%
05/28/04	Oncor Electric Delivery II	\$786,777	6.83	4.913%
08/14/03	Oncor Electric Delivery	\$500,000	6.85	4.844%
01/31/02	Central Power & Light	\$767,335	8.02	5.970%
10/17/01	Reliant Energy	\$748,897	7.80	5.233%

CenterPoint Energy Transition Bond Company III, LLC
 General Electric Transition Bonds, LLC

\$488,472,000

2008 Senior Secured Transition Bonds (A-1/A-2)

7.11 Year Weighted Yield

4.782%

Citi

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Press on CEHE III Offering: IFR Article and PUCT Release

ABS MARKET: Investors Take Shine to CNP's Transition Bonds New York, January 30.

CenterPoint's (CNP) \$488 million offering of utility transition bonds was granted a hearty reception by investors. A simple two maturity structure in five-year and 10-1/2 yr tenors proved to be the right formula for the Houston-based energy company.

Citigroup and Credit Suisse teamed up as joint bookrunners with Morgan Stanley as a non-books co-lead. The \$300m class A-1 opened with official guidance of Swaps plus high 60s BP to Swaps+70bp and the \$188.3m class A-2 began marketing at Swaps+high 90s to plus 100bp. Whisper chatter prior to the guidance announcement was +75bp for the 5s and +100bp on the longer piece.

With the book building in a short period to several times oversubscribed, the shorter bond priced at Swaps+64bp to yield 4.192% and the 10+YR stamped at interpolated Swaps+94bp for a 5.234% yield.

PUCT News Release: Thursday, January 31, 2008

Lower Costs for CenterPoint area Customers

Securitization Reduces Transition to Competition Costs

Electric customers in the CenterPoint Energy service area in and around Houston will save *more than \$109 million in costs* over the next 12 years as a result of the lowest securitized bond rates since retail electric competition began in Texas.

"Securitization will reduce electricity costs by millions of dollars in the CenterPoint service area," said PUC Chairman Barry Smitherman. "These savings are possible through the efforts of Gov. Rick Perry and the leadership of the Texas Legislature in making necessary changes in the law to help electric customers."

House Bill 624 approved by the 80th Texas legislature in 2007 extended securitization to competitive transition costs beyond limits imposed in the original 1999 Texas Electric restructuring law. The law allows securitization only if there is a benefit for customers.

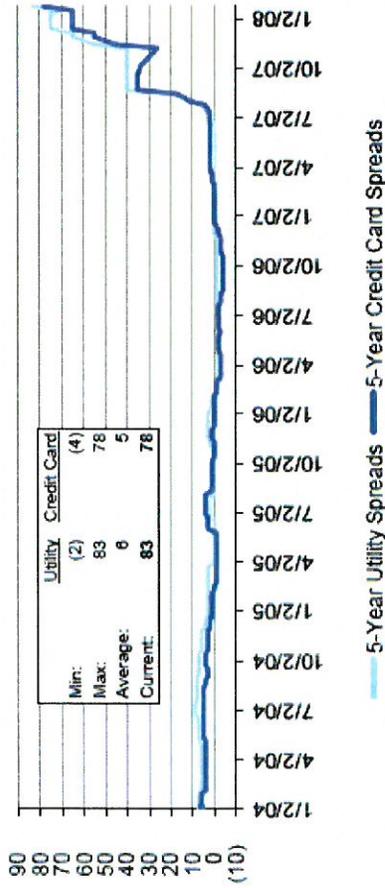
This week's pricing of approximately \$488 million in CenterPoint securitization bonds resulted in very favorable interest rates of 4.19 percent for \$300 million in five-year bonds and 5.23 percent for \$188 million in ten-year bonds. This is a substantial reduction from what would have been an 8.06 percent interest rate without securitization. CenterPoint is expected to close on these bonds in a few weeks.

Securitized debt provides funding at a lower cost than traditional utility funding because of the risk reduction that securitization gives to bondholders.

ABS Market Spread Monitor: Cards and "Stranded"

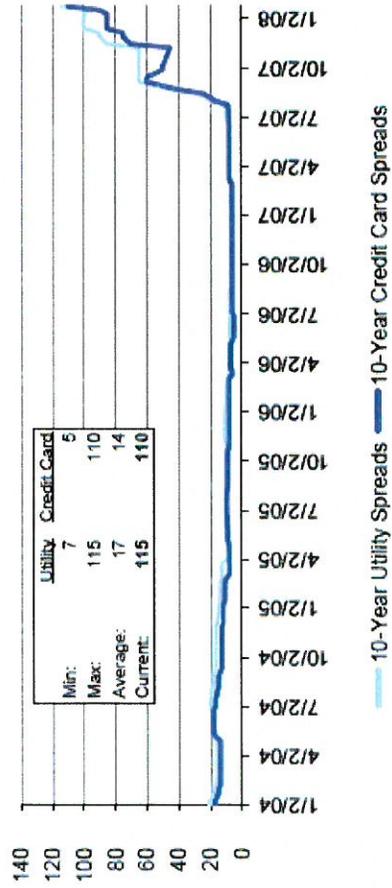
Citi Bond Market Roundup: Strategy — Data Appendix, January 25, 2008
24 Jan 08

5-Year AAA ABS Spreads



Triple-A	Spread (bp)
2-Yr	75
Auto	58
Credit card	85
Equipment	63
Stranded Assets	100
3-Yr	68
Auto	110
Credit card	73
Equipment	78
Stranded Assets	83
5-Yr	90
Credit card	95
Stranded Assets	110
7-Yr	115
Credit card	110
Stranded Assets	115
10-Yr	
Credit card	
Stranded Assets	

10-Year AAA ABS Spreads



Mat.	Sector	25 Jan
1 Yr.	Fin.:	20
2 Yrs.	Fin.:	180
3 Yrs.	Fin.:	195
5 Yrs.	Util.:	135
	Ind.:	125
	Fin.:	375
10 Yrs. ^d	Util.:	135
	AA	145
	A	150
	BBB	190
	AAA	135
	AA	155
	A	175
	BBB	240
	AAA	180
	AA	220
	A	425



Overview of Texas Securitization Framework

Texas has seen six previous transition bond offerings (\$6.43 billion) and one storm recovery bond offering (\$329.5 million); CEHE itself has sponsored two of the previous transition bond offerings totaling \$2.6 billion.

- The Restructuring Act (SB 7) became effective on September 1, 1999
 - Authorized competition in the retail electric market and the electricity generation market beginning in 2002
 - Required a rate freeze for all retail electric customers until 2002, and access to certain reduced rates for residential and small commercial retail electric customers for up to five years thereafter
 - Required certain integrated electric utilities to separate their business into the following units: a power generation company; a retail electric provider (REP); a transmission and distribution utility
 - Provided for recovery of qualified costs and for the 2004 proceeding to determine CEHE's recoverable true-up balance
 - Provided for securitization of a portion of the true-up balance through "transition charges," including a framework for a financing order and the state pledge to adjust transition charges to ensure expected transition charge revenues are sufficient to make timely payment of transition bonds
- In offerings in Oct. 2001 and Dec. 2005, CEHE issued \$2.6 billion of Transition Bonds in aggregate pursuant to this securitization framework
- In June 2007, the Restructuring Act was amended to allow securitization of true-up balance amounts being collected through the Competition Transition Charge (CTC)
 - This amendment provides a framework for CEHE to securitize the remainder of the amounts determined in the Dec. 2004 order
- On September 18, 2007, the Public Utility Commission of Texas (PUCT) issued a Financing Order to CEHE authorizing the issuance of approximately \$500 million of transition bonds
- The transition charges in the CEHE III offering comprise an estimated 0.3% of the customer's bill; in aggregate with the other two securitizations, the percentage is about 3.4%



Recent Precedent Texas Securitizations

Offer Date	Issuer	Tranche	Coupon	Expected Final	Legal- Final (Yrs)	Amount (\$mm)	WAL (Yrs)	Yield (%)	Price (%)	Reoffer Spread
01/29/08	CenterPoint Energy Transition Bond Company III, LLC	A-1	4.192%	02/01/2017	3.00	\$301.427	5.00	4.192%	99.9161%	Swap-84
01/29/08		A-2	5.234%	02/01/2020	3.00	\$187.045	10.52	5.234%	99.94074%	Swap-84
	Total/Average					\$488.472	7.11	4.691%	4.782%	(Time Weighted)
05/22/07	Energy Gulf States Reconstruction Funding I, LLC	A-1	5.51%	10/01/2012	1.00	\$93.500	2.99	5.510%	Var	Swap-2
05/22/07		A-2	5.79%	10/01/2017	1.00	\$121.600	7.99	5.790%	Var	Swap-6
06/22/07		A-3	5.93%	04/01/2021	1.25	\$114.400	12.24	5.930%	Var	Swap-6
	Total/Average					\$328.500	8.06	5.759%	6.334%	(Time Weighted)
10/04/06	AEP Texas Central Transition Funding II, LLC	A-1	4.98%	01/01/2010	2.00	\$217.000	2.00	4.972%	99.99565%	Swap-7
10/04/06		A-2	4.98%	07/01/2013	2.00	\$341.000	5.00	4.989%	99.94159%	Swap-2
10/04/06		A-3	5.09%	07/01/2015	2.00	\$250.000	7.58	5.094%	99.99516%	Swap-3
10/04/06		A-4	5.17%	01/01/2018	2.00	\$437.000	10.00	5.174%	99.94852%	Swap-6
10/04/06		A-5	5.3053%	07/01/2020	2.00	\$494.700	12.68	5.304%	99.99937%	Swap-14.1
	Total/Average					\$1,738.700	8.44	5.135%	6.182%	(Time Weighted)
12/09/05	CenterPoint Energy Transition Bond Company II, LLC	A-1	4.840%	03/01/2009	2.00	\$250.000	2.0	4.840%	99.98928%	Swap-3
12/09/05		A-2	4.970%	08/01/2012	2.00	\$366.000	5.0	4.974%	99.96013%	Swap-0
12/09/05		A-3	5.090%	02/01/2014	1.00	\$252.000	7.5	5.089%	99.99640%	Swap-5
12/09/05		A-4	5.170%	03/01/2017	2.00	\$515.000	10.0	5.172%	99.97450%	Swap-7
12/09/05		A-5	5.302%	08/01/2019	1.00	\$462.000	12.7	5.302%	100.00000%	Swap-13
	Total/Average					\$1,861.000	8.28	5.189%	5.177%	(Time Weighted)

Expected Principal Balance and Amortization Schedules

Date	A-1	A-2	Total	Date	A-1	A-2	Total
02/12/08	\$301,427,000	\$187,045,000	\$488,472,000	02/12/08	5.00 yr WAL	10.52 yr WAL	7.11 yr WAL
02/01/09	280,924,856	187,045,000	467,969,856	02/01/09	\$20,502,344	\$0	\$20,502,344
08/01/09	268,256,701	187,045,000	455,301,701	08/01/09	12,667,955	0	12,667,955
02/01/10	251,782,046	187,045,000	438,827,046	02/01/10	16,474,653	0	16,474,653
08/01/10	237,856,224	187,045,000	424,904,224	08/01/10	13,922,824	0	13,922,824
02/01/11	219,982,954	187,045,000	407,027,954	02/01/11	17,876,270	0	17,876,270
08/01/11	204,690,875	187,045,000	391,735,875	08/01/11	15,292,079	0	15,292,079
02/01/12	185,303,088	187,045,000	372,348,088	02/01/12	19,387,786	0	19,387,786
08/01/12	168,762,944	187,045,000	355,807,944	08/01/12	16,540,144	0	16,540,144
02/01/13	148,092,709	187,045,000	335,137,709	02/01/13	20,670,235	0	20,670,235
08/01/13	130,422,319	187,045,000	317,467,319	08/01/13	17,670,390	0	17,670,390
02/01/14	108,584,646	187,045,000	295,629,646	02/01/14	21,837,673	0	21,837,673
08/01/14	89,707,258	187,045,000	276,752,258	08/01/14	18,877,388	0	18,877,388
02/01/15	66,561,475	187,045,000	253,606,475	02/01/15	23,145,783	0	23,145,783
08/01/15	46,371,221	187,045,000	233,416,221	08/01/15	20,190,254	0	20,190,254
02/01/16	21,811,317	187,045,000	208,856,317	02/01/16	24,559,904	0	24,559,904
08/01/16	211,722	187,045,000	187,256,722	08/01/16	21,599,595	0	21,599,595
02/01/17	0	161,178,513	161,178,513	02/01/17	211,722	25,866,487	26,078,209
08/01/17	0	138,058,931	138,058,931	08/01/17	0	23,119,582	23,119,582
02/01/18	0	110,286,031	110,286,031	02/01/18	0	27,772,900	27,772,900
08/01/18	0	85,435,383	85,435,383	08/01/18	0	24,850,648	24,850,648
02/01/19	0	55,813,565	55,813,565	02/01/19	0	29,621,819	29,621,819
08/01/19	0	29,133,713	29,133,713	08/01/19	0	26,879,852	26,879,852
02/01/20	0	0	0	2/1/2020	0	29,133,713	29,133,713

6



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AAA Rated Comparable Pricing

Symbol	Coupon	Maturity	Issue Size (\$ MM)	WAL (yrs.)	Spread Over Interpolated Treasuries (bps)	Spread Over Interpolated Swaps (bps)
MRK	4.375	2/15/2013	\$500	8.8	52	-2
JNJ	3.800	5/15/2013	500	9.1	44	-9
TVA	4.750	8/01/2013	1,500	9.3	61	+9
FHLB	4.500	9/16/2013	3,000	9.4	60	+10
FHLMC	4.500	1/15/2014	6,000	9.7	59	+11
PFE	4.500	2/15/2014	750	9.8	50	+3
FNMA	4.125	4/15/2014	4,000	10.0	59	+9

Yield spreads from Bloomberg BGN (or, if not available, BFV) prices as of 5/15/04.
Source: Bloomberg



Analysis of Ohio Power Co. Structuring and Pricing of \$267,408,000 Ohio Phase-In Recovery Bonds

EXECUTIVE SUMMARY

- Ohio Power Co. (OPCo or the Company) ratepayers will pay **at least an additional \$3 million in interest and fees** on the \$267,408,000 Phase-In Recovery Bonds (PIR Bonds) sold on July 23, 2013. To prevent this outcome from becoming accepted precedent that raises ratepayer costs for future utility securitizations, it is imperative to analyze the “lessons learned” from this transaction.
- The Public Utilities Commission of Ohio (PUCO) retained independent financial advisors, Public Resources Advisory Group and Oxford Advisors (PRAG–Oxford), to “serve as joint decision maker [with the issuer] on all matters related to structure, pricing and marketing of the bonds.”
 - PRAG is a top rated general municipal bond advisor, and of the 45 corporate utility securitizations sold since 2000, has been an advisor for one in 2007.
 - Oxford has not been involved in any previous corporate utility securitization.
- To provide transparency and accountability, PUCO directed its advisors to issue a [public report on the bond issue](#), with specific attestations concerning the pricing relative to comparable securities. The docket is open for public comment.
- While the bond coupons benefited from extraordinarily low US Treasury benchmark rates, a conservative analysis of the PRAG-Oxford report reveals that PRAG–Oxford made or recommended decisions on the structuring, marketing and pricing of the PIR Bonds that will cost Ohio ratepayers the following:
 - At least **\$1.3 million in higher interest expense** caused primarily by the decision to sell two tranches of PIR Bonds with 2.25-year and 5.08-year weighted average lives (WALs) instead of one tranche as had been recommended by the underwriters with a 3.34-year WAL and the same amortization schedule. This also appears to have been caused in part by PRAG-Oxford’s use of unusual and inappropriate bond “comparables” in its analysis and decision-making process, *i.e.*, comparing the highest quality PIR Bonds to lesser quality auto loans and floor lease asset backed securities (ABS) that have higher interest rates and credit spreads. For more than 10 years, numerous fixed income research departments, rating agency and other market participants have more appropriately compared utility securitization bonds to AAA-rated credit card ABS or traditional high quality utility bonds.¹ We know of no published reports from any source that compare these bonds credit quality and structure to the securities identified by PRAG-Oxford. These inappropriate comparisons, presumably used by PRAG-Oxford in negotiations with underwriters and investors in selling the bonds, appear to have led to higher PIR Bond interest rates for OPCo customers.
 - Up to **\$1.6 million in excess servicing costs** for the PIR Bonds under the servicing agreement negotiated and approved by PRAG-Oxford with OPCo. Contrary to established market precedent since 2007, PRAG–Oxford approved annual servicing costs of 10 basis points (0.10%) of the initial principal amount, which were double the 5 basis points (0.05%) most common on other utility securitization deals, both larger and smaller. Furthermore, PRAG–Oxford did not require that any fees exceeding the Company’s demonstrable incremental PIR Bond servicing costs (over costs already recovered in other rates and charges imposed by OPCo) be credited back to Ohio ratepayers. This provision had been included in other utility securitizations, including those by other subsidiaries of OPCo’s parent company, American Electric Power Company.

¹ See “Absolute Value: Rate Reduction Bond ABS Primer” Wells Fargo Securities, July 17, 2013. See also, Citigroup, “US Fixed Income Strategy – Consumer ABS” August 18, 2006 and Citigroup Research Report (SalomonSmith Barney), “Asset-Backed Global Power/Stranded Asset Roundup,” January 9, 2002.

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**ANALYSIS OF OHIO POWER CO. STRUCTURING AND PRICING OF
\$267,408,000 OHIO PHASE-IN RECOVERY BONDS**



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TABLE OF CONTENTS

	<u>Page</u>
EXECUTIVE SUMMARY	1
Introduction	4
PRAG-Oxford’s Recommendation of a Two-Tranche Structure.....	4
Estimating the Yield for Single-Tranche Alternative on July 23, 2013	7
Single-Tranche Has Savings, Even After Adjustment for Market Judgments	9
Is PRAG-Oxford’s Attestation of “Price Consistent With Market Conditions” Reasonable?	11
Many Precedents of Utility Securitizations With Narrower Spreads than OPCo.....	13
Active Marketing Efforts Demonstrably Drive Pricing Lower	16
Term Sheet and Investor Outreach Are Standard in Utility Securitizations	16
On-Going Costs: Over-Recovery of Costs of Providing Servicing to OPCo	17
Summary and Conclusion	19

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Introduction

The PUCO's financing order required the PIR Bonds to be priced so as to "reflect a market price of most recently issued comparable securities" and to be "consistent with market conditions" at the time of pricing. In furtherance of the PUCO's efforts to achieve transparency and accountability, we have analyzed the reasonableness of the structuring and pricing of the PIR Bonds.² This analysis is based solely on publicly available information. Every dollar spent in this transaction is a ratepayer dollar.

In finance, the price any new issue of bonds can only be evaluated by examining the "credit" or "pricing" spread of the bonds over established market benchmarks, such as US Treasuries or swap³ rates. This is because, while the level of the benchmark rate is not in control of market participants, at least to some extent the spread is. Simply looking at the coupon or yield, which is the combination of the benchmark plus the spread, can be misleading because most of the coupon (the benchmark) is not affected by negotiations with the market. The pricing or credit spread over the appropriate benchmark, however, is.

Our analysis shows that, while the coupon rates benefitted from the continuing low benchmark interest rate environment, the PIR Bonds were mis-structured and mispriced. In addition, it appears that provisions in the Servicing Agreement relating to certain upfront and ongoing costs were needlessly costly to ratepayers. It is important to analyze and discuss these issues in order to establish "lessons learned" and to prevent these issues from becoming accepted precedent, especially in connection with any future PIR Bonds issued in Ohio.

PRAG-Oxford's Recommendation of a Two-Tranche Structure

One of the most troubling aspects of the OPCo PIR Bond sale concerns the structuring of the deal into two tranches⁴ rather than one. This caused the bond sale to use a higher benchmark and pricing spread. PRAG-Oxford states in their report that "the underwriters had proposed a single pass-through tranche but PRAG-Oxford requested early in the market discussions that they [the underwriters] continue to evaluate a 2-tranche structure," which is the structure that was ultimately used.⁵

² The most direct source of information concerning the circumstances under which the PIR Bonds were priced is the PRAG-Oxford report. This was required by PUCO's financing order and is publicly available on the PUCO website under [Case No. 12-19ATS69-EL-ATS](#). In that report, PRAG-Oxford attests that they "participated fully with the Applicant [Ohio Power] . . . as a co-equal in all plans and decisions related to pricing, marketing and structuring of the PIR Bonds". Pricing and other information related to cash flows and tranche credit spreads are on file with the SEC (*see* OpCo [Prospectus Supplement](#)).

³ A common benchmark rate based on LIBOR (London Inter-Bank Offered Rate).

⁴ A "tranche" is similar to a separate class of bonds with its own separate interest rate and maturity/repayment schedule.

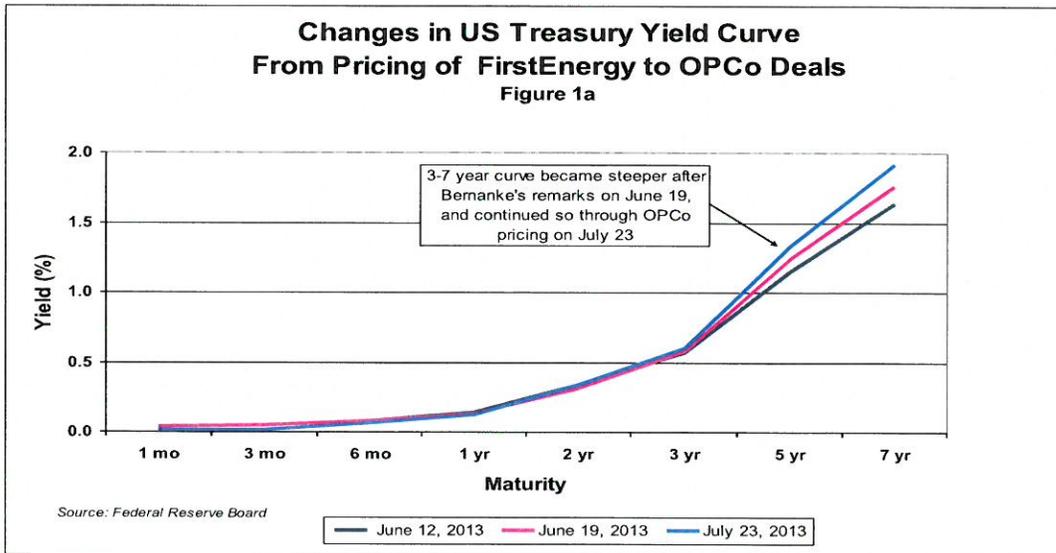
⁵ The Company had proposed to use a 2-tranche structure under different market conditions. *See* p. 10 of the financing order: "Ohio Power explains that it will issue two specific tranches (classes) of bonds with different fixed interest rates and maturity dates. Tranche A-1 will be in the amount of \$149,000,000 with a proposed interest rate of .58 percent and an expected maturity of 3.71 years. Tranche A-2 will be in the amount of \$149,018,000 with a proposed interest rate of 1.55 percent and an expected maturity of 6.71 years." (Ohio Power, Revised Ex. C, March 12, 2013) According to the PRAG-Oxford report, the underwriters prudently suggested changing to a one-tranche structure, but appear to have been overruled by PRAG-Oxford.

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The PRAG-Oxford report goes on to say that “due to the steepening of the yield curve and changing market conditions, the 2-tranche structure did provide a lower borrowing cost and greater savings for the ratepayers.” However, there is no analysis in the PRAG-Oxford report supporting this claim.

In fact, the evidence cited in the PRAG-Oxford report for a “steepening of the yield curve and changing market conditions” was the rise in yields of 10-year Treasury bonds following comments by Federal Reserve Chairman Ben Bernanke on June 19, 2013 about future Federal Reserve open market bond purchases.

While interesting, the chart in the PRAG-Oxford report showing the rise in 10-year Treasury yields is misleading in the context of PIR Bonds. OPCo bonds have much shorter maturities than 10-year Treasury bonds. As seen in **Figures 1a and 1b**, there was little or no steepening of the yield curve for securities due in three years or earlier.



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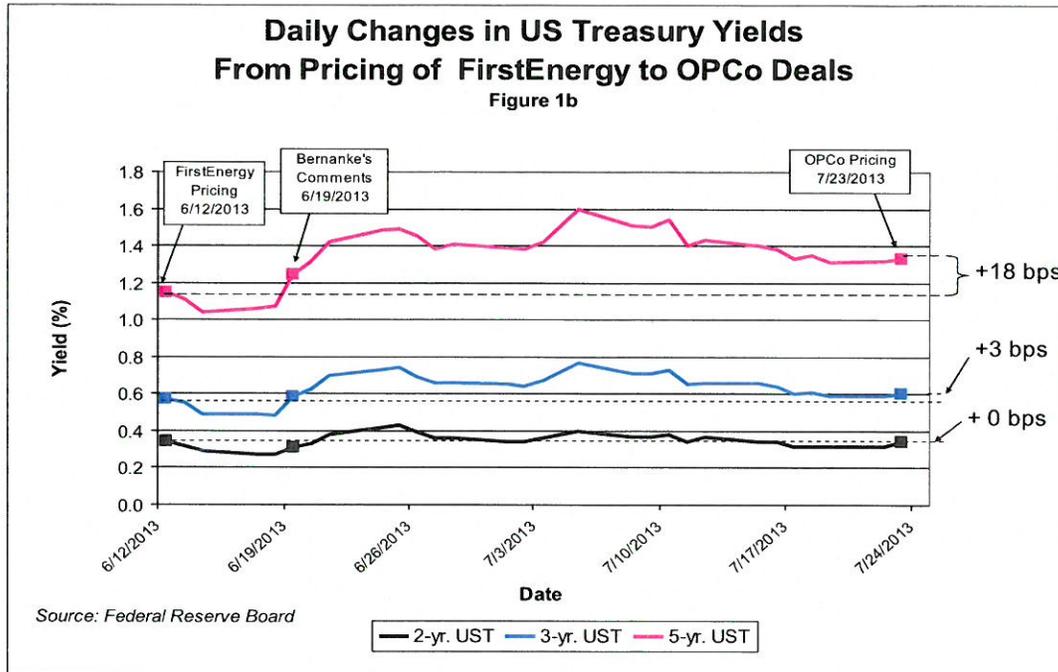
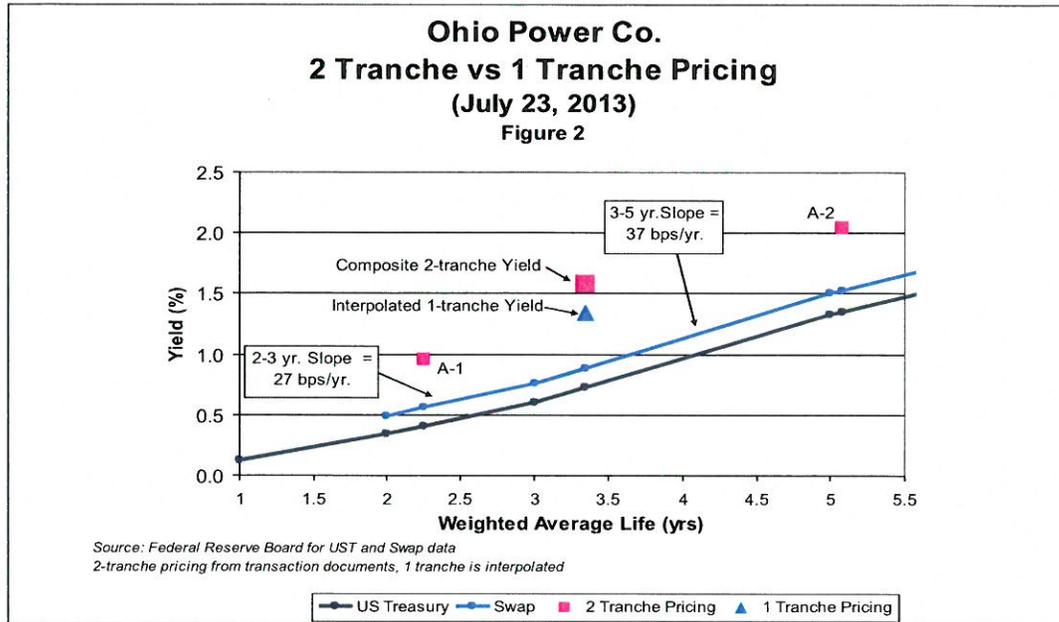


Figure 2, below, shows the yield curves for both US Treasuries and swaps for 2 to greater than 5 years on the day of pricing, July 23. The slope of the swap curve is significantly steeper from 3 to 5 years than from 2 to 3 years (+37 vs. +27 basis points⁶ (bps)/year).

Pricing a single tranche of PIR Bonds at a 3.34-year WAL between OPCo's 2.25 and 5.08 year WALs could have avoided most of the steeper part of the curve. Ratepayer costs could have been reduced by concentrating on market demand from investors preferring three-year securities, like AAA-rated credit card ABS, U.S. agency debt or highly-rated electric utility bonds . . . *without any change to the amortization schedule which is the most significant factor affecting the customer's bill.*

⁶ A basis point equals 1/100th of 1%.

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Estimating the Yield for Single-Tranche Alternative on July 23, 2013

Using standard market conventions and only information available at the time of pricing, it is possible to calculate how a single tranche deal might have been priced. *(It is important to note that no part of this analysis is based on “after-the-fact” information.)* We can thereby estimate the savings that could have been achieved through a single tranche structure.

If OPCo’s PIR Bonds had been structured with a single tranche, that single tranche would have had a 3.34-year WAL. It is important to note that the single tranche PIR Bond issue would have required no change in the schedule of principal payments from the two-tranche structure. Using standard market conventions, the yield on this one-tranche structure can then be compared to the actual yield for the 2-tranche OPCo PIR Bond structure. One standard market convention for securitized utility bonds is to develop pricing benchmarks based on the Federal Reserve’s Treasury and swap yield curve data on the date of pricing. Another standard market convention is to interpolate on a straight-line basis between actual Treasuries and swap yield data available on the pricing date.

- (i) On July 23, 2013 (the PIR Bond pricing date and according to the pricing memorandum filed by OPCo with the SEC), the swap benchmark rate at 3 years was 0.76% and at 5 years was 1.5%. By interpolation, the swap benchmark rate at 3.34 years was 0.886%.
- (ii) The pricing spread for the A-1 tranche of OPCo’s PIR Bonds over interpolated swaps was +40 bps at 2.25 years and for the A-2 tranche was +52 bps over

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interpolated swaps at 5.08 years.⁷ **The pricing spread over interpolated benchmark swaps at 3.34 years was therefore 45 bps** (rounding up).

- (iii) 0.886% plus 45 bps (line (i) + line (ii)) produces a yield of 1.336% for a single tranche PIR Bond deal.
- (iv) The PRAG-Oxford report states that the composite rate for the two-tranche deal was 1.580%.⁸
- (v) The difference between the 2-tranche yield of 1.58% and the 1-tranche yield of 1.336% is a savings of 0.244% (line (iv) – line (iii)). **That is more than 24 bps savings.**
- (vi) The yield differential times the principal amount times the years outstanding (*i.e.*, WAL) gives a **nominal savings of \$2,177,692.**

⁷ Pricing Term Sheet, dated July 23, 2013.
http://www.sec.gov/Archives/edgar/data/1577459/000090514813000747/efc13-465_fwp.htm.

⁸ This was verified (roughly) in Table 1, below.

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The calculation of single tranche pricing for OPCo’s PIR Bonds and forgone savings is shown in **Table 1**, below:

Forgone Savings in OPCo				
2-Tranche Pricing vs. Interpolated Single-Tranche Pricing				
Table 1				
RRB Extrapolated Yield Curve				
Maturity (yrs)	Swap Yield (%)	Pricing Spread (%)	Yield (%)	
2.00	0.490			
2.25	0.558	0.40	0.958	A-1 Tranche yield
3.00	0.760			
3.34	0.886	0.45	1.336	Possible single tranche pricing
5.00	1.500			
5.08	1.528	0.52	2.048	A-2 Tranche yield
7.00	2.120			
Composite Yield for 2-tranche deal			1.580	Wtd. Avg. Yield
		interpolated		
Check Composite Yield for 2-tranche deal				
Maturity (yrs.)	Principal Amt. (\$)	PA * WAL (\$ - years)	Yield Calc. Check (%)	
2.25	164,900,000	371,025,000	0.958	
5.08	102,508,000	520,740,640	2.048	
Wtd. Avg	3.34	267,408,000	891,765,640	1.594
Forgone savings				
			Yield (%)	
			2-tranche deal	1.580
			1-tranche deal	1.336
			yield savings	0.244
				x P.A x WAL
			= Nominal \$ Savings	\$ 2,177,692
<i>Sources: Swap spreads from Federal Reserve Board 2-tranche pricing spreads, composite 2-tranche yield, WALs and principal amounts from PRAG Letter</i>				

Single-Tranche Has Savings, Even After Adjustment for Market Judgments

As described in more detail below, only a limited marketing or sales effort was undertaken after filing of the registration statement and preliminary prospectus on May 21, 2013 in connection with OPCo’s PIR Bonds. With such limited efforts to identify, contact and communicate with investors, it *may* not have been possible to achieve all the savings assumed in the calculations in Table 1 due to the longer payment window (the period during which principal is being repaid) inherent in a single tranche structure. Generally, shorter payment windows are more attractive to investors, which encourage them to accept lower yields. Single-tranche utility securitizations are unusual, but not unheard of, especially for deals with shorter WALs and relatively small principal amounts.

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For example, on August 11, 2010, Entergy Arkansas Restoration Funding, LLC (Morgan Stanley Lead Underwriter) issued \$124.1 million of Storm Recovery Bonds in a single tranche with a WAL of 5.44 years, a repayment window of 9.5 years and a pricing spread of +55 basis points to swaps. For OpCo, the repayment window of 5.5 years was narrower than the Entergy Arkansas sale, whether OPCo was structured with one tranche or two.⁹

As Table 1 showed, at the time of the OPCo sale, a straight interpolation shows a swap benchmark rate of 0.896% and a pricing/credit spread of +45 bps.

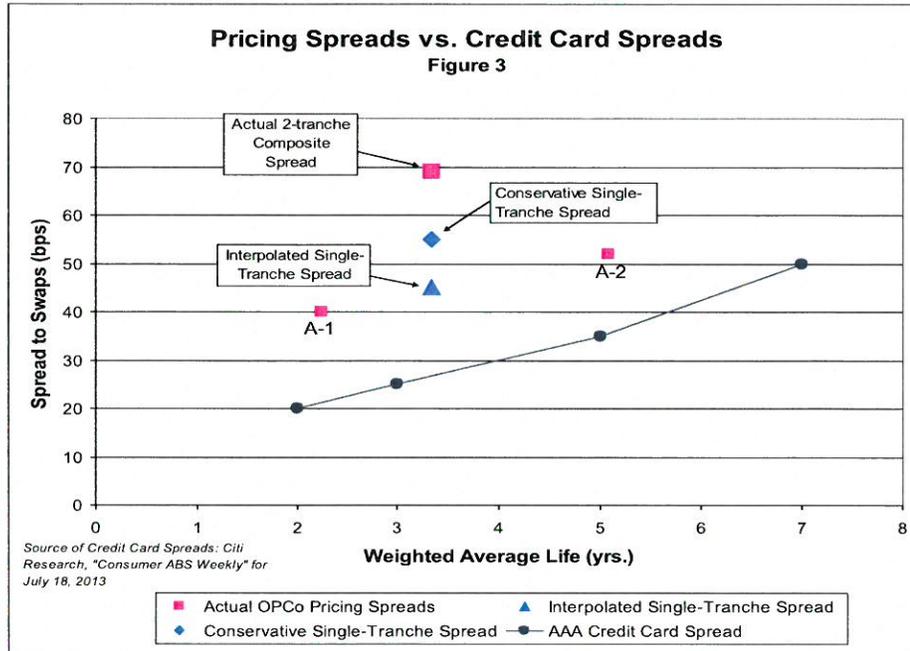
To be conservative, because of the difference between the WAL and the longest possible maturity, we used an additional spread premium of 10 bps as a “fair value” adjustment to the credit spread.

Thus, a 3.34-year swap rate of 0.886% plus a 0.55% (45 bps + 10 bps) credit spread yields a conservatively estimated single-tranche rate of 1.436%. Comparing this to the actual composite rate of 1.58% resulting from the two-tranche structure **still yields a savings of over 14 bps, which translates to nominal interest savings of \$1,285,926.**

The savings from using a single tranche structure is robust: the pricing spread would need to have increased to an unlikely +69 bps rather than +45-55 bps before the savings from a single-tranche structure would have been eliminated. Given the relationship to AAA-rated credit card ABS spreads shown in **Figure 3**, it does not seem plausible that a single-tranche PIR Bond deal would have required a +69 bps pricing spread to attract investors.

⁹ Sometimes even multi-tranche deals have longer payment windows. For example, on January 29, 2008 CenterPoint Energy priced utility securitization bonds in a 2-tranche structure where the A-1 tranche (\$301 million principal) had a WAL of 5.0 years with a payment window of 8 years. On April 3, 2007 Allegheny Energy (subsidiaries Monongahela and Potomac Edison) priced a 4-tranche deal where the A-1 tranche had a 4-year WAL with a 7-year payment window at spreads *below* credit cards. Saber Partners was the Commission’s advisor on that transaction.

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Is PRAG-Oxford’s Attestation of “Price Consistent With Market Conditions” Reasonable?

PRAG-Oxford seem to have ignored market research (including that of the underwriters as discussed below) and precedents in their analysis of the PIR Bonds’ pricing.¹⁰

In discussing the pricing of the PIR Bonds, the PUCO’s advisors asserted they negotiated narrower spreads than first proposed by underwriters. Those statements rely wholly on the indications of underwriters with no fiduciary duty to the issuer/ratepayers, and are no substitute for an independent, rigorous evaluation of relevant comparable securities, pricing of previous issues and investor preferences. In anticipation of tough negotiations, investment banks commonly propose “generous” spreads so that even if after negotiations result in a spread reduction, the bonds still carry a higher-than-necessary credit spread making the sale easier.

In discussing the A-1 tranche having priced at +40 bps over swaps, PRAG-Oxford asserts that the pricing “conforms to the broader Asset Backed Securities (‘ABS’) new issuance market of utility securitization, prime auto, and auto lease ‘ABS.’” They point to “the significant increase in credit spreads” since the FirstEnergy transaction on June 12 (the most recent utility securitization transaction), in addition to the difference in WAL, to explain why the A-1 tranche was priced at 40 bps over swaps, whereas the FirstEnergy A-1 tranche was priced at just 25 bps over the benchmark rate. However, the FirstEnergy A-1 tranche

¹⁰ See the pricing of PSE&G Transition Funding II, LLC, MP Environmental Funding, LLC, PE Environmental Funding, LLC ad FPL Recovery Funding, LLC.

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benchmark was not the swap curve but the Eurodollar Synthetic Forward (EDSF), so the pricing spread is not strictly comparable.

More importantly, experienced market participants do not view AAA rated auto ABS as the best “comparable securities” to AAA-rated utility bonds like the PIR Bonds. More typically and more appropriately, as numerous fixed income research, rating agency and other market participants have stated for more than 10 years, utility securitization bonds are most comparable to AAA-rated credit card ABS or traditional high quality utility bonds including U.S. agencies.¹¹ We know of no published reports from any source that compare securitized utility bonds to the securities identified by PRAG-Oxford.

This incorrect selection of comparables makes a material difference to ratepayers. **Table 2**, below, shows the difference between yields on AAA-rated auto loan and AAA-rated credit card ABS securities from June 12, 2013, when the FirstEnergy transaction was priced, to July 23, 2013, when OPCo’s PIR Bonds were priced. While AAA-rated credit card ABS spreads to swaps increased by 10-12 bps in the 2-3 year range (comparable to the A-1 tranche WAL of 2.25 years), AAA-rated auto loan ABS spreads increased by 16-18 bps. Thus, by benchmarking against inappropriate “comparables,” the PRAG-Oxford report exaggerated the extent of the increase in credit spreads since the FirstEnergy sale, thus laying the groundwork for mispricing the PIR Bonds.

Credit Spreads for Auto Loan ABS vs. Credit Card ABS Spread to Swaps (bps)					
Table 2					
	AAA Auto Loan ABS		AAA Credit Cards		
	2-year	3-year	2-year	3-year	5-year
June 6, 2013	12	17	10	13	25
July 18, 2013	28	35	20	25	35
Increase	16	18	10	12	10

Source: “Consumer ABS Weekly,” Citigroup Research, July 18, 2013

In discussing the A-2 tranche, PRAG-Oxford takes credit for reducing the underwriters’ initial spread recommendation from +60-65 bps downward to +52 bps. The FirstEnergy A-2 tranche with a similar 5.1-year WAL priced at +40 bps. PRAG-Oxford attributes the increased spread over the FirstEnergy deal to the “considerable movement in the public credit markets,” although the 5-year credit card ABS spread only increased by 10 bps (from +25 to +35 bps) from June 6 to July 18. They also say that their A-2 pricing “conforms to the broader ABS new issuance market of utility securitization and prime auto ABS,” even though there are no 5-year AAA-rated auto ABS issuances with which to compare. Citigroup’s Fixed Income Research Department does not provide even indicative levels for 5-year auto ABS,

¹¹ See “Absolute Value: Rate Reduction Bond ABS Primer” Wells Fargo Securities, July 17, 2013. See also, Citigroup, “US Fixed Income Strategy – Consumer ABS” August 18, 2006 and Citigroup Research Report (SalomonSmith Barney), “Asset-Backed Global Power/Stranded Asset Roundup,” January 9, 2002.

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although they do so for credit card ABS and utility securitizations (which they refer to as “stranded asset” bonds).¹²

The PRAG-Oxford report also states “when PRAG-Oxford pressed the underwriters to lower the spread by another 1-2 bps on the day of pricing, we were informed that the transaction could not handle any additional reduction in spread.” In a negotiated transaction, underwriters may say this, but the proof would be to see the composition of orders from all underwriters. Was there a written marketing plan? Did co-managers or just the lead managers receive orders? How were the orders distributed? What type of buyers? Were there “crossover” buyers as noted by Citi in the 2008 deal? Is the deal was 100% or more “subscribed” at that point, or if the underwriters might still have had to actually underwrite some portion of the deal at the time it was priced.

If marketing was limited (offering to a select few of buyers) and produced only a few investors in the book e.g., less than 5-10 then that is a self-imposed risk. Broad participation and competition is necessary to avoid a few investors driving the pricing higher.

If the deal is 100% sold and the underwriters do not take any risk of underwriting, then it cannot be said with confidence that the “transaction cannot handle any additional reduction” of even a basis point or two. It is not unusual for underwriters to actually underwrite 5-15% of a transaction in order to achieve efficient pricing without overpaying all investors in the book of orders.

The PRAG-Oxford report does not say if the underwriters actually underwrote any of the PIR Bond transaction. If the A-2 tranche had been priced at +50 bps instead of +52, reflecting just the 10 bp increase in credit card ABS spreads since the FirstEnergy transaction, the nominal savings to OPCo ratepayers would have been an additional \$104,000.

Many Precedents of Utility Securitizations With Narrower Spreads than OPCo

Citigroup, the lead underwriter for the PIR Bonds and an experienced participant in utility securitizations, has in the past compared their new issue pricing to the estimated yields published weekly by Citigroup’s Fixed Income Research group. In 2008, for example, Citigroup boasted when it sold utility securitization bonds at narrower spreads to swaps than new credit card ABS issues or indicative rates for trades in the secondary market. Many other utility securitizations with WALs comparable to the PIR Bonds have sold with spreads to swaps narrower than those for concurrent credit card ABS.¹³

Citigroup’s 2008 report (available upon request) entitled, “CenterPoint Energy Houston Electric (CEHE) Securitization,” said:

“On Jan. 29, 2008, CEHE priced one of the most successful asset-backed securities (ABS) offering in many months, attracting both traditional asset-backed buyers and corporate “crossover” investors.”

¹² See, e.g., “Consumer ABS Weekly”, Citigroup Research, which publishes rates for auto ABS for 2 and 3 years only.

¹³ See PSE&G Transition Funding II, LLC, MP Environmental Funding, LLC, PE Environmental Funding, LLC and FPL Recovery Funding, LLC.

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“We estimate that each tranche of the CEHE III offering priced approximately 15-25 bp inside of like-maturity credit card securities.”

That report even cited as corroborating evidence a **Citigroup January 24, 2008 research report**¹⁴, (with added, circling the spreads in their CEHE report) for comparable securities, as shown to the right.

Citi Bond Market Roundup: Strategy — Data Appendix, January 25, 2008

		24 Jan 08 Spread (bp)
Triple-A 2-Yr	Auto	75
	Credit card	58
	Equipment	85
	Stranded Assets	63
3-Yr	Auto	100
	Credit card	66
	Equipment	110
	Stranded Assets	73
5-Yr	Credit card	78
	Stranded Assets	83
7-Yr	Credit card	90
	Stranded Assets	95
10-Yr	Credit card	110
	Stranded Assets	115

Indeed, the 2008 offering sold, according to Citi, with a 5-year tranche at +64 bps over swaps and the 10.5-year tranche at +94 bps over swaps. Both spreads were considerably narrower on a “relative value” basis than those indicated by Citigroup Fixed Income Research for credit card or other utility securitizations widely recognized by ABS professionals as the sole comparable security in the ABS market.¹⁵

Consumer ABS Weekly
18 July 2013

Figure 4. Consumer ABS Fixed-Rate Spreads to Swaps

		18 Jul 13 Spread (bp)
Triple-A 2-Yr	Auto	28
	Credit card	20
	Equipment	45
	Stranded Assets	28
3-Yr	Auto	35
	Credit card	25
	Equipment	50
	Stranded Assets	34
5-Yr	Credit card	35
	Stranded Assets	45
7-Yr	Credit card	50
	Stranded Assets	60
10-Yr	Credit card	55
	Stranded Assets	70

Unfortunately for OPCo ratepayers, in connection with the PIR Bonds, Citigroup appears to have negotiated interest rates with the PUCO’s advisors with credit spreads *much wider* than its own research estimates.

The most recent data available to PRAG-Oxford before the PIR Bonds were priced included a **similar July 18 2013 Citigroup research report** (arrows and circles added). (Recall that the pricing was on July 23.) That report showed spreads in their Figure 4 (to the left) over swaps for comparable securities.

Based on those reported spreads, OPCo’s 2-year tranche, priced at +40 bps over swaps, was actually +12 to 20 bps wider than the spreads for utility securitizations or credit card ABS, respectively. The 5-year tranche at +52 bps over swaps was

¹⁴ See “Citi Bond Market Roundup: Strategy- Data Appendix,” Citigroup Research, January 28, 2008

¹⁵ In addition, utility securitization bonds are more comparable to highest quality utility and corporate including government sponsored agency bonds. Utility securitization bonds have special government i.e., regulatory backing and a pledge of non-interference by the state with U.S. constitutional protections. Unlike typical asset-backed securities, the obligation to repay in utility securitizations is cross-shared among generally all electricity customers in the utility’s service territory. There is no finite pool of receivables as in ABS. In any pricing, choosing, the right bonds to compare to is an important sales point and must be done carefully otherwise it leads to higher interest costs as demonstrated in the OPCO and the First Energy pricings.

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+7 bps wider than utility securitizations and +17 bps wider than credit card ABS.

PRAG-Oxford seem to have ignored these estimates - from the research of its lead underwriter - when they attested that “the PIR Bonds reflect a market price of most recently issued comparable securities.” If PUCO’s the PIR Bonds had been priced with credit spreads just equal to other utility securitizations, as estimated by the Citigroup research report (still wider than credit card ABS, not narrower as Citigroup boasted in 2008), ratepayers would have saved an additional \$724,000.

Given the contrast between the PIR Bonds pricing at wider spreads to benchmark swaps than credit card ABS, while similar issues in other states have sold at narrower spreads to swaps than credit card ABS, diligent financial advisors should be concerned. They should ask why proposed pricing levels are much worse than fixed-income research or previous sales would suggest. When investors, bankers and rating agencies agree that utility securitizations are safer, lower risk bonds than those backed by credit card receivables, why should OPCo’s new issue of PIR Bonds sell with higher yields and wider credit spreads than credit card ABS issues, let alone other high quality corporate or other more appropriate comparables?¹⁶

Today, 2013, market conditions for utility securitization bonds are better than 2008. In fact, all independent observers agree that utility securitizations performed *better* during the credit crisis than other structured securities. For example, S&P published a report in 2009 entitled “The Recession has Not Been Hard on “Ratepayer Obligation Charge” Bonds,” their term for utility securitization bonds. At a time when even U.S. Treasury debt lost its triple-A rating, no utility securitization has ever lost its top AAA rating, or been put on a watch list as a candidate for downgrading.

Even a co-manager of the OPCo bonds, Wells Fargo, concluded in a July 2013 research report that ratepayer bonds were a better “credit” than credit card ABS (with no mention at all of auto ABS as comparable). He pointed out to investors that while the utility securitization are a better credit that are being priced *higher* than credit card ABS and therefore a better value to investors.¹⁷ This kind of discrepancy needs to be eliminated or reduced by the diligent efforts of the financial advisor to create a more competitive marketplace for PIR Bonds in negotiations.

If underwriters claimed they couldn’t find buyers to pay close to relative value, perhaps additional firms should have been added to the selling group and adequately rewarded for uncovering demand from investors willing to accept lower yields closer to the inherent value received.

If investors were unaware of utility securitizations or resisted lower yields in exchange for greater security, they should have been educated about how such ratepayer bonds provide both higher credit quality and more predictable repayment schedules than asset-backed securities.

¹⁶ See the pricing of 19-year MP Environmental Funding and PE Environmental Funding utility securitization bonds, December, 2009 that priced at +62 to US Treasuries when Goldman Sachs who had been lead manager for another utility securitization estimated that the bonds would require a yield of +106 to US Treasuries to be sold. Jefferies/The Williams Capital Group were underwriters and Saber Partners, LLC was financial advisor to the commission and joint decision-maker with the issuers.

¹⁷ See “Absolute Value: Rate Reduction Bond ABS Primer” Wells Fargo Securities, July 17, 2013.

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As has been shown on numerous other transactions, increased marketing for greater competition among underwriters and investors can achieve more efficient (*i.e.*, lower) pricing.

Active Marketing Efforts Demonstrably Drive Pricing Lower

The PRAG-Oxford report states that “the underwriters pre-marketed the transaction starting on Wednesday, July 17, 2013 and continued that process through Friday, July 19, 2013.” The deal was “announced” the following Monday and priced on Tuesday, July 23. If this was the extent of the marketing, based on the results described in this analysis, it appears to have been insufficient.

While our analysis is primarily focused on the specific structure and pricing, it is important to understand that marketing efforts significantly impact the ultimate cost of the PIR Bonds. Complex securities need to be “sold” to investors. Also, a broad group of appropriate investors needs to be identified and targeted as part of the marketing effort. Otherwise, a small group of investors may demand too high a premium or there may not be enough competition for the issue. These lead to higher costs.

Based on available information, the marketing for the PIR Bonds seems to have been unnecessarily abbreviated and passive.

After filing a registration statement with SEC, active marketing for indications of interest may begin, but not sales. According to the SEC website, [OPCo's registration statement](#) was filed with the SEC on May 21, 2013—approximately 2 months before PRAG-Oxford state that “pre-marketing” began. Securities laws also allow for the use of a short “term sheet” in addition to the registration statement, which can discuss the key features of the issue and help assess investor demand. This also gives an opportunity to identify appropriate comparables, as well as dispel any misconceptions about the specific issue.

From the time a registration statement and preliminary prospectus is filed with the SEC, “marketing” may begin. No bonds may be sold during this period or firm orders taken, rather only “indications of interest” may be solicited. However, this is the time that investor education may be conducted without any delay whatsoever of the transaction because a registration statement is on file with the SEC waiting to “go effective” at which time the bonds can be sold. Based on the PRAG-Oxford report, this time between filing and pricing seems to have been wasted and used only for “market update” calls between the underwriters and financial advisor.

Term Sheet and Investor Outreach Are Standard in Utility Securitizations

PRAG-Oxford may now claim that they did talk to some investors. However, based on the timeline described in their report and filings with the SEC, it appears they did so without a term sheet or customary marketing materials to help explain the advantages of ratepayer bonds until the very last minute.¹⁸

¹⁸ According to SEC filings, there was no term sheet for use in discussions with investors about relative values until July 17, a scant four business days before the pricing.

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A meaningful report of a financial advisor's activities on behalf of PUCO would describe the extent of the marketing effort: how many investors were contacted, how many meetings or calls with investors were held, what marketing materials were used. Rather than just quoting the investment bankers, a diligent financial advisor would have been involved sufficiently to also detail the size of the "book" at the time of pricing, how those orders were distributed by size and type of investor, the extent of any "over-subscription" and any resultant repricings, and how many investors participated in the final offering.

Not all AAA-rated securities price alike. And not all AAA-rated utility securitization bonds price alike. There are substantive differences that can cost ratepayers money if they are not identified and addressed appropriately. While a lowest cost standard was not mandated by the legislation or the financing order, this does not mean that those responsible for structuring, marketing and pricing should not try to achieve a best execution.

Final pricing (and cost to ratepayers) is normally the culmination of a thorough and energetic marketing effort. Underwriters and advisors should be willing and able to point to specific actions taken to educate investors and broaden investor demand and negotiate a best pricing, fair to all.

On-Going Costs: Over-Recovery of Costs of Providing Servicing to OPCo

The financing order allows the initial PIR Bond servicer to receive both (i) an upfront payment, designed to allow recovery of its initial set-up costs; and also (ii) a fixed periodic fee, designed to allow the initial servicer and any successor servicer to recover their ongoing costs.¹⁹ Like most utility securitizations, the initial servicer of the intangible property that secures the PIR Bonds is the sponsoring utility. Most commonly for similar transactions since 2007 (including other subsidiaries of AEP), the fee allowed for sponsoring utilities has been an annual fee of no more than 0.05% of the initial principal amount of the transaction. In fact, as shown in **Table 3** below, since 2007, only two of 18 utility securitizations allowed servicing fees in excess of 0.06% per year, excluding the two recent Ohio transactions.

For bankruptcy law reasons, the aggregate fees paid to the sponsoring utility must reflect arms-length fair market value consideration for the services provided. Bankruptcy lawyers generally interpret this to require aggregate fees that will at least cover an allocable portion of the sponsoring utility's fully-allocated costs of providing servicing functions.

The financing order authorizes OPCo, as initial servicer, to receive an annual fee equal to 0.10% of the initial principal amount of the PIR Bonds:

"Based upon both estimated costs of performing the servicing function and market precedent for such fees, the Commission determines that the annual servicing fee to be paid to Ohio Power should be 0.10 percent of the initial principal amounts of the PIR Bonds issued by the SPE."²⁰

¹⁹ Because the financing order makes no provision for a successor servicer's recovery of its initial set-up costs, and because a successor servicer presumably would perform no other services in connection with the sponsoring utility, similar financing orders commonly provide for a significantly higher periodic servicing for successor servicers. Thus, page 50 of the financing order allows an annual servicing for successor servicers of up to 0.75% of the initial principal amount of the PIR Bonds.

²⁰ P. 38 of the financing order, Revised Ex. C, March 12, 2013.

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For the reasons described above, this represents an allocable portion of the Company’s fully allocated costs of providing servicing functions.

Maximum Allowed Annual Servicing Fees				
Table 3				
Deal #	Deal Name	Principal Amount (\$)	Wtd. Avg. Life (yrs.)	Max. Annual Servicing Fee on Initial P.A.
1	Ohio Phase-In-Recovery Funding LLC (7/23/2013)	267,408,000	3.33	0.10%
2	FirstEnergy Ohio PIRB Special Purpose Trust (6/12/2013)	444,922,000	9.29	0.10%
3	AEP Texas Central Funding III (3/7/2012)	800,000,000	6.93	0.05%
4	Centerpoint Energy Transmission Bond Co. IV (1/12/2012)	1,695,000,000	7.10	0.05%
5	Entergy Arkansas Energy Restoration Bonds (8/11/2010)	124,100,000	5.44	0.12%
6	Louisiana Utilities Restoration Corporation Project/ELL (7/15/2010) [taxable munis]	468,900,000	6.63	0.03%
7	Louisiana Utilities Restoration Corporation Project/EGSL (7/15/2010) [taxable munis]	244,000,000	6.62	0.06%
8	MP Environmental Funding LLC (12/16/2009)	64,380,000	19.02	0.05%
9	PE Environmental Funding LLC (12/16/2009)	21,510,000	19.02	0.05%
10	CenterPoint Energy Restoration Bond (11/18/2009)	664,859,000	7.26	0.05%
11	Entergy Texas Restoration Funding (10/29/09)	545,900,000	7.21	0.05%
12	Louisiana Public Facilities Authority (8/20/2008)	278,400,000	5.75	0.06%
13	Louisiana Public Facilities Authority (7/22/2008)	687,700,000	5.83	0.03%
14	Cleco Katrina/Rita Hurricane Recovery Funding LLC (2/28/2008)	180,600,000	7.09	0.05%
15	CenterPoint Energy Transition Bond Company III (1/29/2008)	488,472,000	7.11	0.05%
16	Entergy Gulf States Reconstruction Funding I, LLC (6/22/2007)	329,500,000	8.05	0.12%
17	RSB BondCo LLC (BG&E sponsor) (6/22/2007)	623,200,000	5.60	0.05%
18	FPL Recovery Funding LLC (5/22/2007)	652,000,000	7.15	0.05%
19	MP Environmental Funding LLC (4/3/2007)	344,475,000	12.01	0.05%
20	PE Environmental Funding, LLC (4/3/2007)	114,825,000	12.07	0.05%
	Average			0.06%
	Mode (most common)			0.05%

So long as the sponsoring utility continues to send monthly bills to its retail customers, and based on the experience with other utility securitization transactions, the sponsoring utility generally incurs few if any incremental ongoing costs by reason of its role as servicer in connection with the bonds. Because sponsoring utilities generally are already allowed to recover 100% of their costs of providing general billing and collection functions from ratepayers through their general rate case proceedings, this generally results in a windfall over-recovery of costs unless some provision is made for adjusting the sponsoring utility’s other rates and charges.

When it has served as Financial Advisor to State Commissions in connection with the issuance of other utility securitizations, Saber Partners, LLC has ensured that the financing orders and/or Servicing Agreements include specific provisions requiring such adjustments to the sponsoring utility’s other rates and charges. For example, the West Virginia PSC’s financing order authorizing the issuance of similar bonds for Monongahela Power and The Potomac Edison Company states:

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“The Applicants shall credit to consumers through other electric rates and charges the amount of the Applicants’ Servicing Fee in excess of any recorded periodic incremental costs of performing the Servicing functions.”²¹

We have been unable to find any such provision in the OPCo financing order or Servicing Agreement allowing other rates and charges of the Company’s ratepayers to be credited to reflect the Company’s over-recovery of costs. If OPCo, like most other sponsoring utilities, incurs no material *incremental* costs that can be demonstrated by reason of its agreement to function as servicer in connection with the PIR Bonds, the full \$267,408 of *annual* servicing fee might represent over-recovery of costs.

Summary and Conclusion

Whether the PIR Bonds were priced “consistent with market conditions” is an open question. The PIR Bonds clearly were not structured or marketed so as to take maximum advantage of the known market conditions at the time of pricing. Furthermore, it is difficult to give much credence to PRAG-Oxford’s attestations since they reference inappropriate, non-comparable securities and, in the case of the A-2 tranche, non-existent 5-year auto ABS securities.

We conservatively estimate that improved pricing and structuring efforts (use of single-tranche structure and appropriate credit spread benchmarking) could have resulted in savings for ratepayers in the amount of \$1,390,074.

In addition, it appears that certain ongoing costs built into the transaction were greater than necessary. The most significant additional cost relates to the ongoing servicing cost of 10 bps/year on the initial principal amount for the life of the bonds, apparently without any provision for crediting the sponsoring utility’s revenue requirement for other rates and charges to prevent over-recovery of costs. Based on market precedents described above, this amounts to an additional nominal net cost to ratepayers of \$791,082 due to a cap that is 5 bps *above* the norm and another \$791,082 because there is no provision to credit fees in excess of actual (and verifiable) incremental costs.²² If OPCo can demonstrate actual additional unrecovered costs for any future period, this amount could be less. However, since the issue was never raised, we may never know. One of the responsibilities of an experienced financial advisor to a utility commission is to identify these types of issues for review, investigation and decision.

²¹ **West Virginia Case Nos. 05-0402-E-CN and 05-0750-E-PC (April 7, 2006), page 86.** See also **California PUC D.04-11-015 (November 2004), page 48** (“PG&E shall credit to electric consumers the amount of this servicing fee in excess of any recorded incremental servicing costs.”); **Florida PSC Docket No. 060038-EI, Order No. PSC-06-0464-FOF-EI (May 30, 2006), Finding of Fact 114(b)** (“FPL has not justified that the annual fee is necessary to cover any incremental costs to be incurred by FPL in performing ongoing services as servicer. Thus, we find that FPL shall apply to the Reserve all amounts it will receive under the Servicing Agreement for ongoing services.”)

²² The forgone savings related to the annual serving fee, while large in the OPCo deal, are many times larger in the FirstEnergy transaction, where the expected final maturity is in 20.57 years rather than just 5.92 years, and the initial principal amount upon which the fee is calculated is 1.7 times as large.

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A summary of the potential forgone savings in this transaction (using the conservative single-tranche pricing calculated above) is presented in **Table 4**, below:

Forgone Savings Table 4		
Item	Quantified by	Approximate Nominal Forgone Savings (\$)
Pricing based on correct AAA- rated credit card ABS benchmark rather than hypothetical AAA- rated auto ABS benchmark	A-2 pricing at +50 vs. 52 bps	\$ 104,148
“Best-Execution” structuring	Conservative estimate of 1-tranche vs. 2-tranche pricing	1,285,926– 2,177,692
Ongoing servicing cost cap consistent with most prior utility securitization transactions	Cap fee at 5 bps/yr. vs. 10 bps/yr. on initial principal amount	791,082
Credit servicing fee in excess of actual (likely zero) incremental cost	Reducing net cost of servicing fee to zero	791,082
Total²³		2,972,238– \$ 3,864,004

Simply by using public information, known market conventions and available market research, we conclude that the OPCo PIR Bond transaction left substantial ratepayer savings “on the table.” This resulted from mispricing and mis-structuring, and from accepting non-standard upfront and ongoing costs. More experience with structuring, marketing and pricing of utility securitizations specifically, and of the unique history of this market, could have helped Ohio capture these savings for the benefit of OPCo’s ratepayers. This likely would have covered the financial advisor’s fee many times over.

²³ Note that this total of forgone savings does not explicitly include the amount related to failure to price at the Citigroup published rate for asset backed securities (an additional \$724,000), which is a further indication of the conservative nature of the foregone savings shown in this Table 4.



Servicer Set-up Costs Estimates (\$)

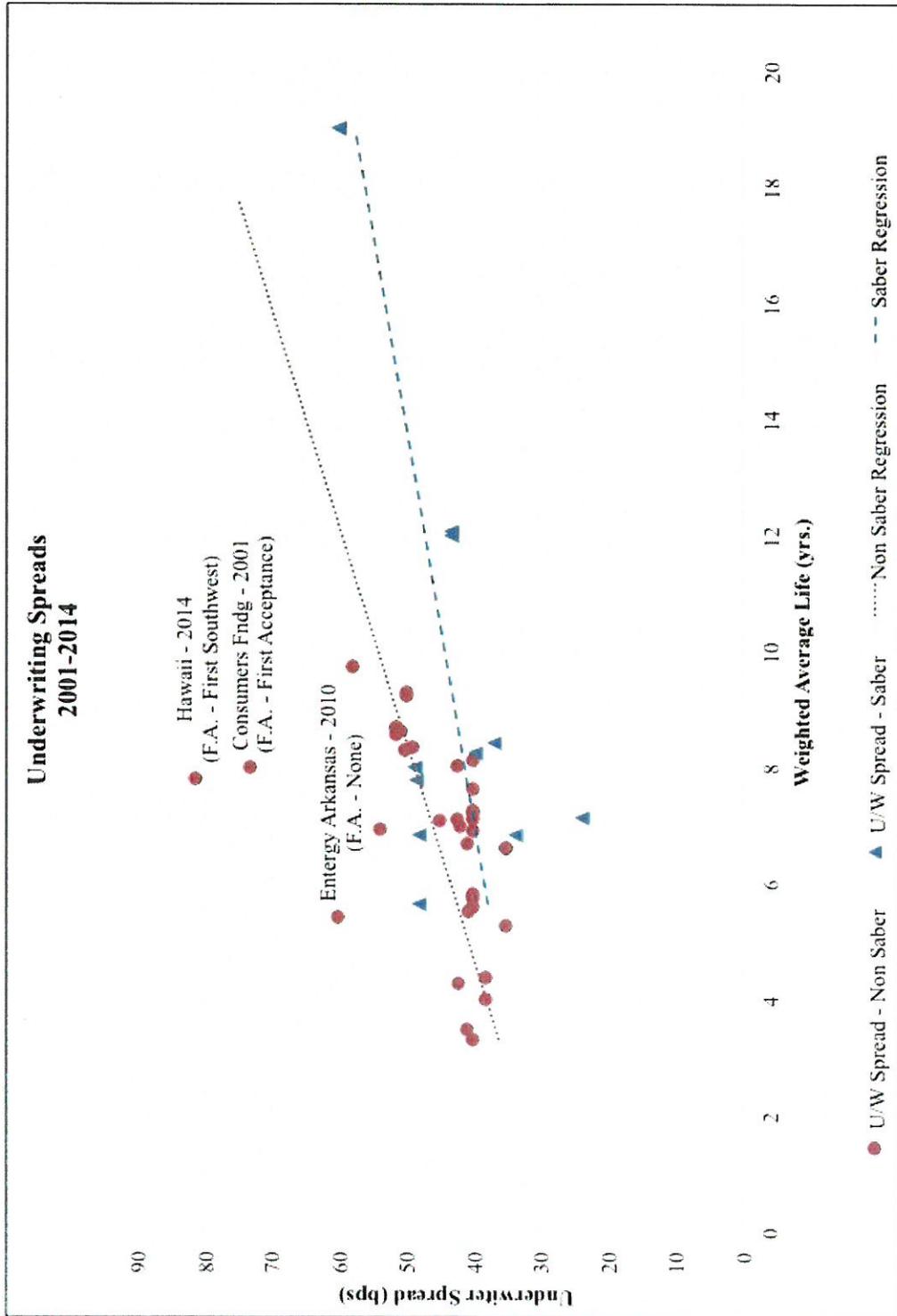
Deal Name	Date of Issuance	Deal Size	Reported Servicer Set-up Fees Set-up fees
Reliant Energy	10/24/01	748,897,000	14,880 †
Central Power & Light ^	2/7/02	797,334,897	43,717 †
Oncor Electric Delivery ^	8/21/03	500,000,000	0 †
TXU Electric Delivery ^	6/7/04	789,777,000	0 †
Centerpoint Energy ^	12/16/05	1,851,000,000	315,200
AEP TCC ^	10/11/06	1,739,700,000	30,000
PE Environmental Funding * ^	4/11/07	114,825,000	N/A
MP Environmental Funding * ^	4/11/07	344,475,000	N/A
FPL Recovery ***	5/22/07	652,000,000	401,382 †
Entergy Gulf States	6/29/07	329,500,000	402,116
Centerpoint ^	2/12/08	488,472,000	149,327
Entergy Texas ^	11/6/09	545,900,000	50,000
Centerpoint Energy ^	11/25/09	664,859,000	45,000
PE Environmental Funding * ^	12/23/09	21,510,000	N/A
MP Environmental Funding * ^	12/23/09	64,380,000	N/A
Louisiana Utilities	7/22/10	468,900,000	50,000
Entergy Arkansas **	8/18/10	124,100,000	140,000
Entergy Louisiana	9/22/11	207,156,000	100,000
Centerpoint Energy	1/19/12	1,695,000,000	PA
AEP TCC ^	3/14/12	800,000,000	N/A
FirstEnergy	6/20/13	444,922,000	300,000
OhioPower ^	8/1/13	267,408,000	N/A
APCo ^	11/15/13	380,300,000	50,000
LIPA	12/18/13	2,022,324,000	50,000
Consumer Energy Company ^	7/22/14	378,000,000	N/A
State of Hawaii ^	11/13/14	150,000,000	353,907
Entergy New Orleans	7/22/15	98,730,000	50,000
ELL & EGSL ***	7/15/10	244,000,000	50,000 †
ELL & LPSC ***	7/15/10	468,900,000	100,000 †
DEF low estimate	1/1/16	1,311,800,000	1,900,000
DEF high estimate	1/1/16	1,311,800,000	2,900,000

† Servicer set-up actual cost, N/A Not available, PA Paid by Applicant.

Source: Issuance Advice Letter, * Pricing Advice Letter, ** Issuance Report Letter, *** Other.

(^) Indicates expenses were capped.

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Source: Transaction documents, SEC forms.

I N V E S T M E N T D E A L E R S ' D I G E S T



A \$1Mil Carrot For Co-Managers

Christopher O'Leary (christopher.oleary@tfn.com)

Feb 11, 2002

A recent \$797 million stranded utility asset securitization had **extremely tight pricing** in part because of a deal structure that gave underwriters greater initiative to expand their selling efforts beyond the norm and offered the chance for co-managers to divvy up an additional \$1 million bonus based on how well they priced and sold the bonds.

At first glance, the deal seemed like an investor's nightmare—a first-time issue for a Texas power utility, Central Power and Light Co., securitizing assets it received as part of a state power deregulation agreement, the likes of which have been tarred due to the California energy crisis. What is more, the deal was priced soon after the fall of Enron Corp., which likely would have been a major player in the just-deregulated Texas energy market if it hadn't imploded. Finally, the deal's lead manager, Goldman Sachs, was a marginal player in asset-backed securities, having ranked just fourteenth in global ABS last year.

Yet Goldman and the deal's co-managers pulled off a pricing coup. Prices on most of the deal's tranches were substantially tightened, by more than 10 basis points for some tranches, so that **the stranded-asset deal priced in the same range as a typical credit-card securitization, which is considered the ABS market's "gold standard."** The deal's pricing range was seven to 34 bps, while comparable stranded-asset deals have had ranges of nine to 67 bps.

What appears to be market prestidigitation can be explained quite simply. The deal's arrangers-issuers CPL Transition Funding LLC (a subsidiary of CPL Co.) and the Public Utility Commission of Texas, along with the latter's adviser, Saber Partners LLC—put together **a unique type of structure** that made the deal's co-managers a much more integral part of the game. It also offered a \$1 million bonus pool to be awarded solely at its discretion to the co-managers based on their performance. The result: pricing so tight that future deals from Texas' deregulation program will likely have a similar carrot-and-stick structure, officials involved with the deal said.

Consider it a reversal of recent fortune. The co-manager slot on a debt financing deal is now generally more political than effectual. Because the lead manager of a deal has become more dominant in how a deal gets allocated and priced, some co-managers wind up essentially serving face time in deals. Also, because of the growing interlinking between lending and debt underwriting, issuers frequently dole out co-manager slots to banks with whom they seek to curry favor, or with which they have done recent business, regardless of such banks' expertise.

This deal turned all that thinking on its ear. What CPL, the PUC and Saber were after was the best performance possible out of their underwriters. Already, by choosing Goldman as a lead manager, the issuers had a hungry underwriter with something to prove. "Goldman did a great job overall," said Joseph Fichera, chief executive officer of Saber Partners.

The real meat, however, was reserved for the co-manager roles. Bear, Stearns & Co., Credit Suisse First Boston, Citigroup/Salomon Smith Barney and Merrill Lynch & Co. were all brought into the fold, and given much greater incentive than normal for such a role. First, the issuers split up the deal's allocation 50/50: Goldman handled 50% of the deal's allocation, while the four co-managers and Goldman divvied up the remainder, a generous allowance, to say the least.

Also, **all the underwriters were competing to win a slice of the \$1 million prize. "We would judge their performances; it was completely discretionary based upon the decision of the company, the Commission and us,"** said Saber Partners' Fichera. Top honors for co-managers went to Bear and Merrill.

CenterPoint Energy Transition Bond Company II, LLC
Senior Secured Transition Bonds, Series A
\$1,851,000,000



Confidential

CenterPoint Energy Transition Bond Company II, LLC

A dark green rectangular box with white text. The text is centered and reads: '\$1,851,000,000', 'Senior Secured Transition Bonds, Series A', 'Pricing Book', and 'December 19, 2005'. At the bottom of the box, there is a small disclaimer in a smaller font.

\$1,851,000,000
Senior Secured Transition Bonds, Series A
Pricing Book
December 19, 2005

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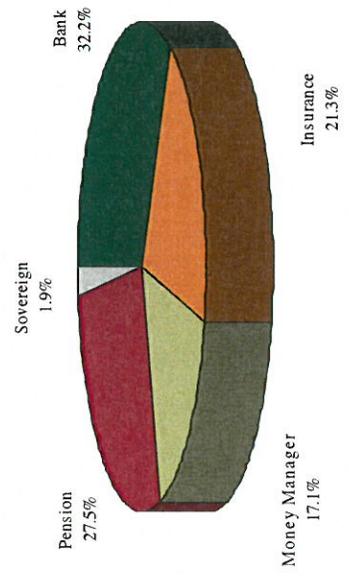
Investors

Investor Details

Investor Participation Profile – Investor Type

Investor Type	Amount	Percentage ⁽¹⁾	Percentage of Disclosed Total ⁽¹⁾	Number of Unique Disclosed Investors
Bank	504,000,000	27.2%	32.1%	6
Pension	431,000,000	23.3%	27.5%	1
Insurance Money Manager	334,500,000	18.1%	21.3%	12
Manager	270,100,000	14.6%	17.2%	15
Sovereign	30,000,000	1.6%	1.9%	2
Disclosed Total	1,569,600,000	84.8%	100.0%	36
Total Co-Manager Undisclosed	68,400,000	3.7%		
Total Lead Manager Long	213,000,000	11.5%		
Total Bonds	1,851,000,000	100.0%		

Percentage of Disclosed Total



1. Figures may not sum to totals due to rounding.

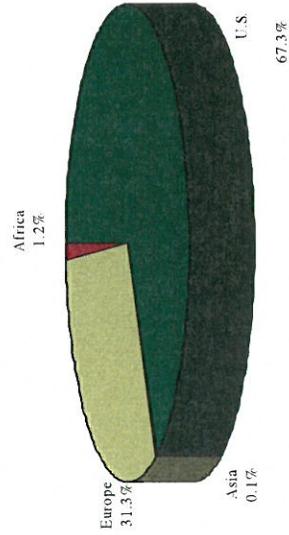
Investors

Investor Details

Investor Participation Profile – Investor Location

Investor Location	Amount	Percentage ⁽¹⁾	Percentage of Disclosed Total ⁽¹⁾	Number of Unique Disclosed Investors
U.S.	1,056,850,000	57.1%	67.3%	32
Europe	491,750,000	26.6%	31.3%	2
Africa	19,000,000	1.0%	1.2%	1
Asia	2,000,000	0.1%	0.1%	1
Disclosed Total	1,569,600,000	84.8%	100.0%	36
Total Co-Manager Undisclosed	68,400,000	1.9%		
Total Lead Manager Long	213,000,000	11.5%		
Total Bonds	1,851,000,000	100.0%		

Percentage of Disclosed Total



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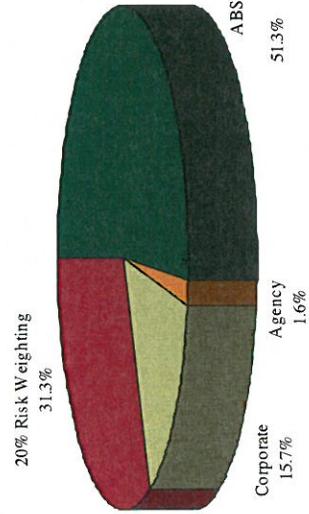
Investors

Investor Details

Investor Participation Profile – Investor Universe

Investor Universe	Amount	Percentage ⁽¹⁾	Percentage of Disclosed Total ⁽¹⁾	Number of Unique Disclosed Investors
ABS	805,250,000	43.5%	51.3%	19
20% Risk Weighting	491,750,000	26.6%	31.3%	2
Corporate	247,000,000	13.3%	15.7%	13
Agency	25,600,000	1.4%	1.6%	2
Disclosed Total	1,569,600,000	84.8%	100.0%	36
Total Co-Manager Undisclosed	68,400,000	3.7%		
Total Lead Manager Long	213,000,000	11.5%		
Total Bonds	1,851,000,000	100.0%		

Percentage of Disclosed Total



1. Figures may not sum to totals due to rounding.

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RATINGS DIRECT®

July 8, 2009

The Recession Hasn't Been Hard On "Ratepayer Obligation Charge" Bonds

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Table Of Contents

ROC Bonds Are Outperforming Other ABS Asset Classes

We Expect The Stable Performance To Continue

The Statutory True-Up Mechanism Supports The 'AAA' Ratings

Their Names May Have Changed, But Their Versatility Keeps Growing

The Recession Hasn't Been Hard On "Ratepayer Obligation Charge" Bonds

Some investors may know them as stranded-cost bonds or rate-reduction bonds. These days, Standard & Poor's Ratings Services is calling them ratepayer obligation charge (ROC) bonds, and they're gaining market attention again because of their strong performance during this recession. ROC bonds are backed by usage-based charges that, pursuant to state statutes, electric utilities may assess and collect from their customers. To date, utilities have issued approximately \$40 billion of these bonds, all of which have retained their 'AAA' ratings. Over the past 15 years, many of them have performed through severe natural disasters, an energy market crisis, one major utility bankruptcy, and now, the worst U.S. recession in 50 years.

The strong performance of these bonds, along with the funding efficiency they've given utilities and ratepayers, has, in our view, encouraged market participants to find new uses for them. Originally, ROC bonds were associated with stranded costs from the late 1990s and early 2000s--costs that utility companies incurred that they weren't able to recoup because of industry deregulation. Standard & Poor's believes that the ROC bond sector may be poised to play a larger role in funding prospective investments in the U.S. energy sector, such as construction of nuclear power plants or environmental remediation.

ROC Bonds Are Outperforming Other ABS Asset Classes

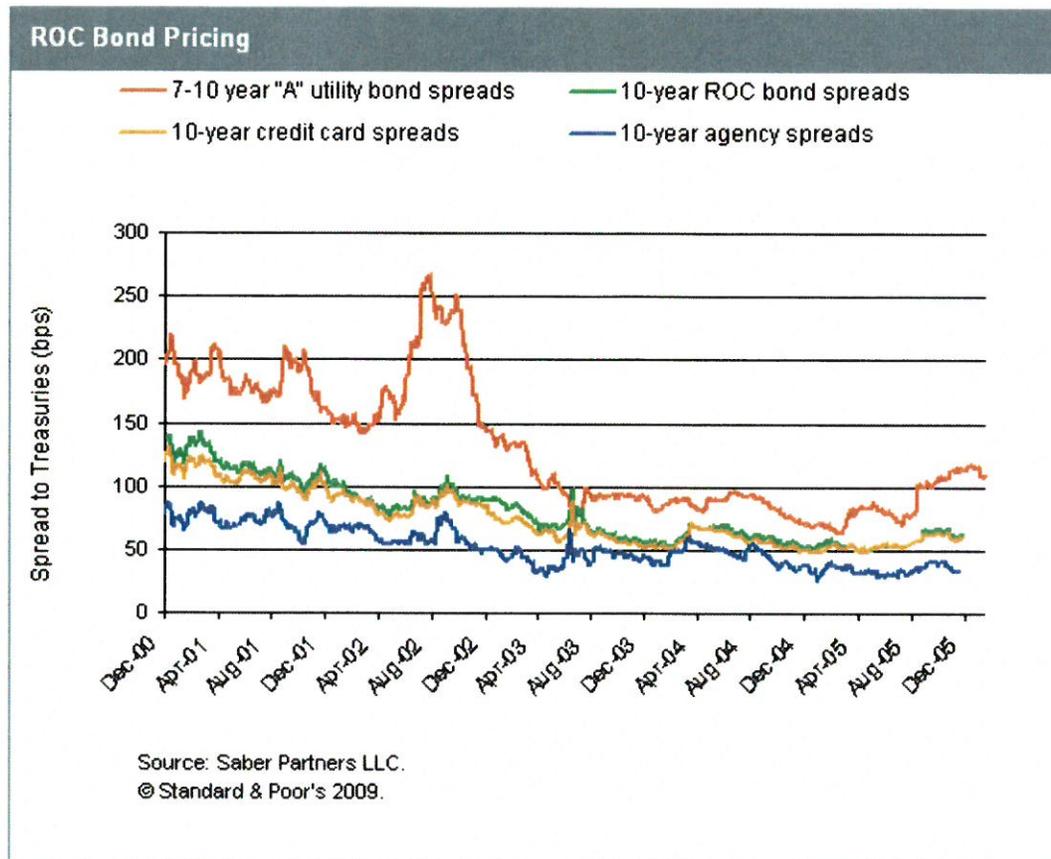
This recession has led to downgrades of some asset-backed securities (ABS) backed by consumer assets--such as auto loans, auto leases, and credit cards--due to poor collateral performance. According to our data, however, ROC bonds have shown no material weakness in performance to date.

Current spread levels for ROC bonds, when compared with those for other benchmark ABS bonds, appear to us to reflect this credit stability. According to secondary-market participants, as of the end of May, some five-year "stranded-utility" bonds were trading around 75 basis points (bps) inside the spreads of 'AAA' credit card ABS of the same tenor (duration). And some 10-year ROC bonds were trading closer to Small Business Administration (SBA) guaranteed pooled certificates, which we understand many market participants consider to be benchmark government-sponsored-entity (GSE) securities due to their government guarantee. Although we believe the secondary market is fairly thin, most supplies are trading at a premium, according to market sources.

ROC bonds' general immunity to prepayment risk may be another positive factor behind their currently strong pricing, in our opinion. It wasn't always this way, though. Before 2007, many ROC transactions attempted to achieve pricing parity with benchmark credit card ABS or GSE debt (see chart 1). According to one industry source, Saber Partners LLC, new-issue pricing spreads of ROC bond issues in five states closely tracked those of comparable 'AAA' credit card ABS, but, for the most part, remained higher until the beginning of the current credit market dislocation.

The Recession Hasn't Been Hard On "Ratepayer Obligation Charge" Bonds

Chart 1



We Expect The Stable Performance To Continue

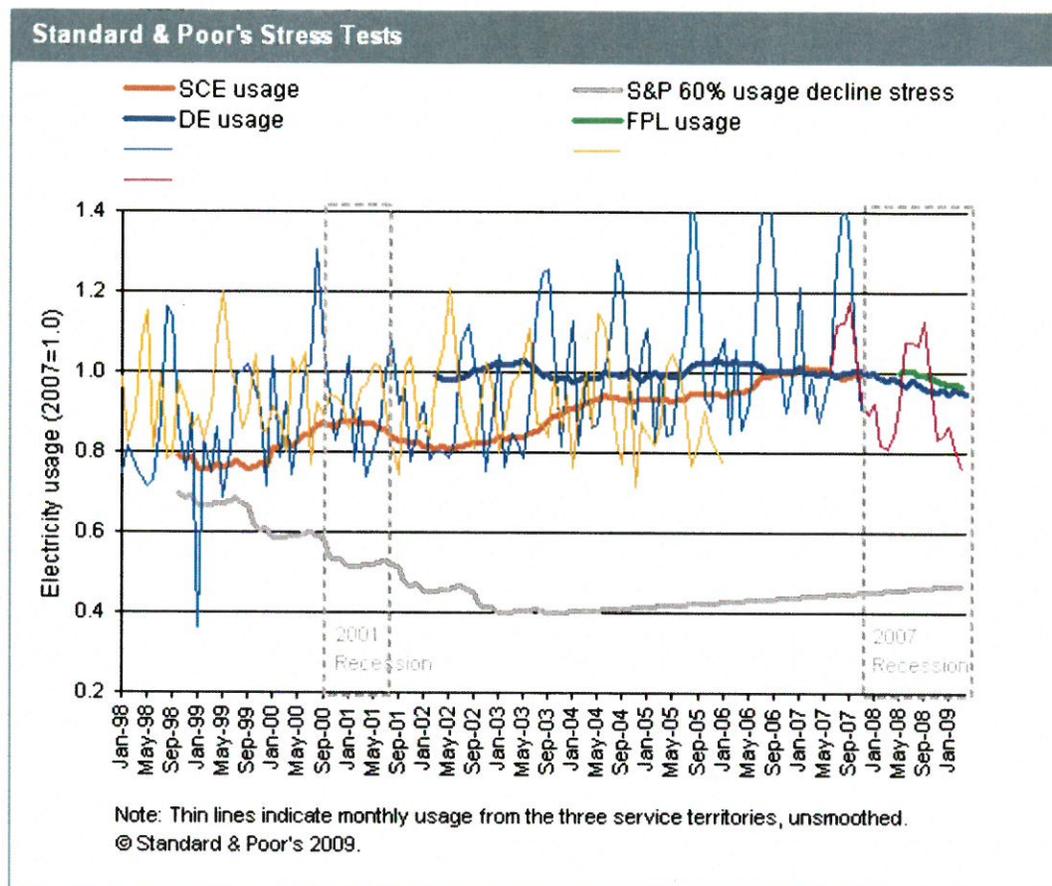
Over the past 15 years, the ROC bond sector has faced--and, we believe, withstood--several shocks, including the 2001 California energy crisis, which brought Pacific Gas and Electric Co. (PG&E), a ROC-bond issuer and servicer, to bankruptcy. Natural disasters have struck as well. Hurricane Rita, for example, shut down the Houston metropolitan area (a major ROC service territory) for days, yet failed to result in a material reduction in collections.

The current recession has had disproportionate effects on the country geographically, hitting some states, such as Michigan and Florida, the hardest. Both of these states fall in service territories whose utilities have issued ROC bonds. Such territories include Southern California Edison (SCE), Detroit Edison (DE), and Florida Power & Light (FPL). Usage trends have shown modest declines, consistent with the 2001 recession (and the California energy crisis) for SCE and with the 2007 recession for Detroit Edison and FPL. In contrast, in our 'AAA' stress tests, we assume a usage decline of between 60% and 80% (see chart 2).

Our 'AAA' stress test for the SCE service territory contains five consecutive usage declines of 12% for each of the first five years of the transaction's life. The scenario further assumes an increase in usage at the long-term growth rate of 2%-3% following the initial five-year annual decrease of 12%. In our view, the magnitude of this stressed usage decline scenario reflects the combination of population decline, migration of commercial and industrial users

out of the service territory, and the increased use of onsite generation, which may entitle customers to bypass the related usage charge.

Chart 2



Our usage patterns show that use of electricity in regions suffering from double-digit unemployment in recent years (Michigan and Florida), devastating natural disasters (Texas), and rolling blackouts (California) remained within our 'AAA' stress factors for the ROC bonds that we rate.

The Statutory True-Up Mechanism Supports The 'AAA' Ratings

State statutes require the utilities to perform and the regulators to implement a periodic true-up, which is a reassessment of the level of the charge to electricity users for the purpose of satisfying debt service in full and on time. In its simplest form, this feature essentially makes a service territory's ratepayers (including residential, commercial, industrial, and governmental) into "joint and several" obligors, allowing, for example, a 10% drop in industrial electricity usage in one period to be mitigated (i.e., made whole) by an increase in charges to all other ratepayers in the next collection period.

Once the related legislation passes, this statutory true-up mechanism is irrevocable until the ROC bonds are paid off. Unlike the general obligations of state and local governments, ROC bonds are insulated from the periodic

budgetary process, generally allowing the bonds to have higher ratings than those backed by the general obligations of state and local governments.

We believe the political environment may be shifting in favor of ROC bonds as ratepayers recognize the projected lower funding costs associated with the bonds' 'AAA' ratings. ROC bonds also tend to allocate a lower amount of collections for debt service than do the bonds that utilities issue. This "dollar-revenue-for-dollar-debt," or 1x debt service coverage, can be a highly efficient financing feature.

Their Names May Have Changed, But Their Versatility Keeps Growing

In recent years, ROC bonds have gone by a variety of names as market participants tried to capture their uses, including:

- Stranded-cost bonds.
- Rate-reduction bonds. (Although bond issuance generally causes a slight increase in the ratepayers' all-in utility bill, the relatively cheaper financing costs result in a relatively lower charge increase on the ratepayers.)
- Energy or storm-recovery bonds.
- Environmental trust bonds.

We believe this "identity crisis" is actually a testament to the versatility of this financing alternative as utility regulators and ratepayer advocacy groups look to expand its applications. It's no longer just about the historical "stranded costs," because the assets and service territories now go beyond the states that were deregulated. Right now, based on our observations, utilities are focusing on funding their future investments and mandated costs.

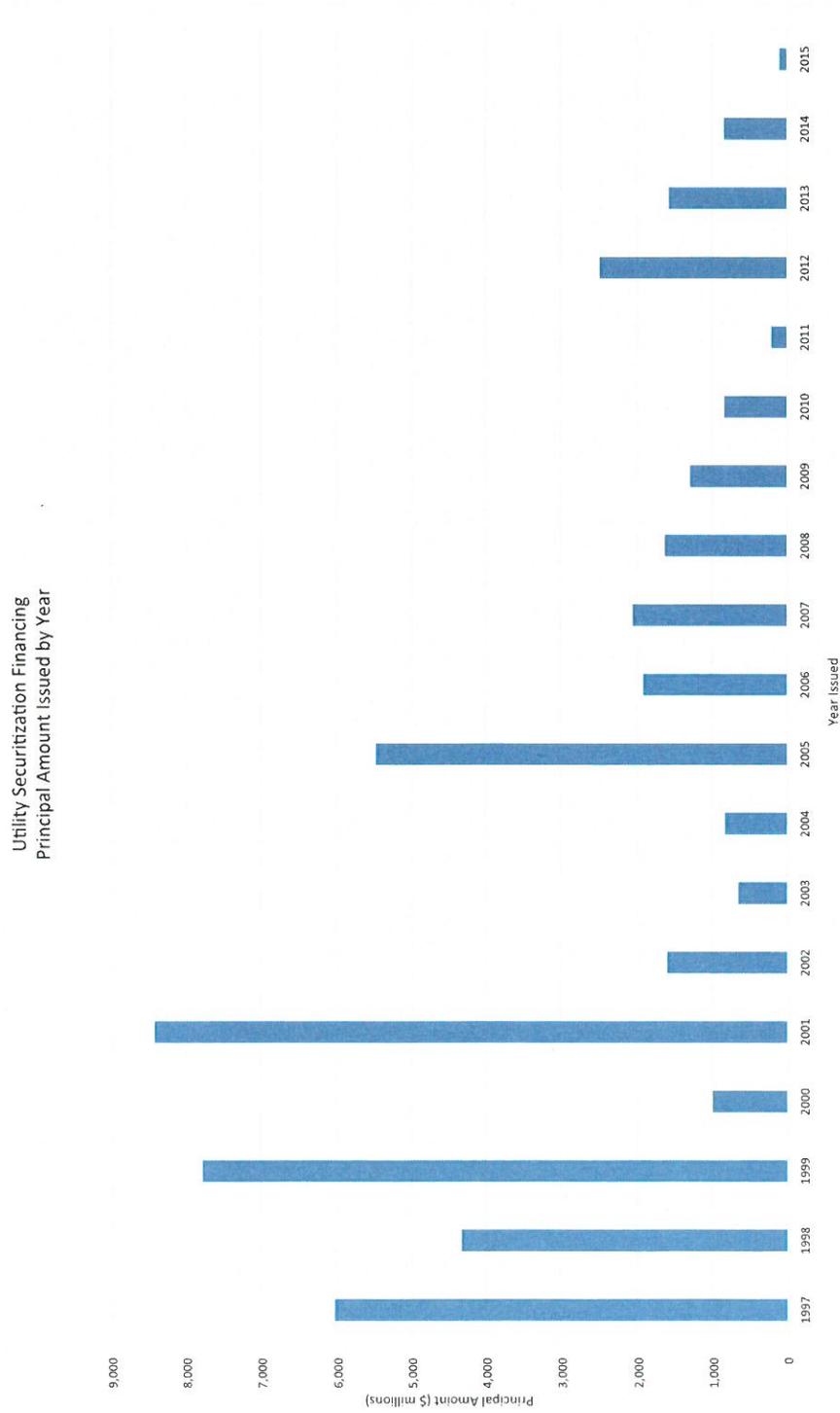
Standard & Poor's expects this financing technique will play a larger role in the funding of future energy-related and other public projects. We're now seeing the application of ROC securitizations for renewable portfolio standards and carbon emissions credits. Progress Energy Florida also recently attempted to use ROC bonds to fund the construction of a nuclear power plant. As interest in the ROC bond sector expands, we will continue to update the market on its developments.

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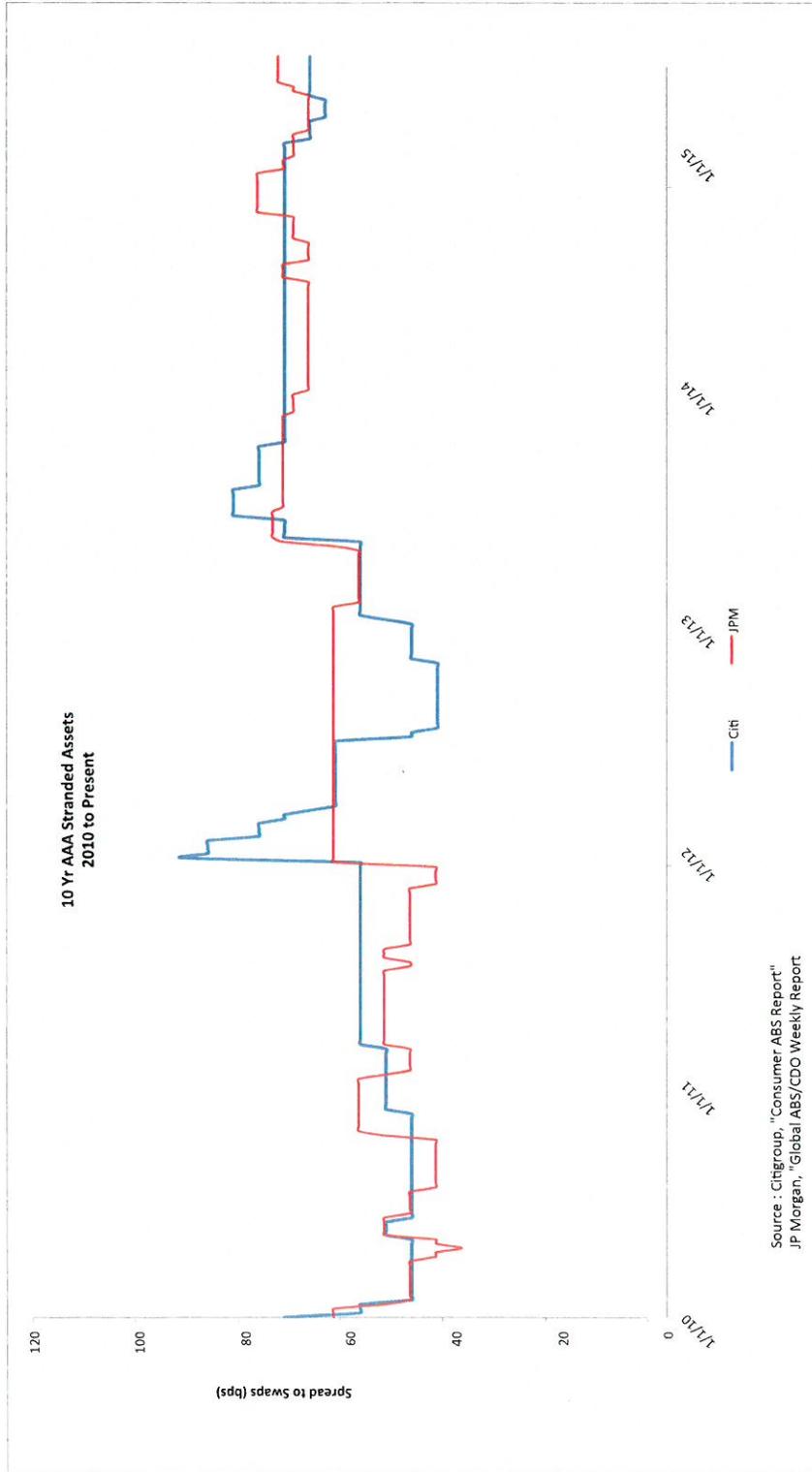
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Source: Transaction documents, SEC forms.



Walter, Jamie

From: mbrello@aep.com

Sent: Wednesday, November 23, 2011 6:23 PM

To: Senator Daniels; Senator Balderson; Senator Seitz; McNab, George; Shawn Nelson; Michael Frazier; district34@ohr.state.oh.us; district21@ohr.state.oh.us; district42@ohr.state.oh.us; McMahon, Vanessa; shawn.kasych@ohr.state.oh.us

Subject: Securitization - Least Cost Standard research/commentary

The email chain below is the result of our request to the bond attorneys at Sidley Austin to research "Least Cost Standard" language in other state's securitization statutes. As you know the OCC has requested adding language to the bill requiring a least cost standard. What we have found, in short, is that requiring such a standard in law leads to greater expenses than savings. Many of the states leave it to the commission to issue in a financing order, if the commission deems necessary. This commission discretion would be allowed under the current version of the bill.

Skip to the "commentary" section of the first email at the bottom of page for a good summary of the research.

Please feel free to call with any questions 614/204-8668.

Thanks,
Mike

----- Forwarded by Thomas G Berkemeyer/OR2/AEPIN on 11/23/2011 07:44 AM -----

"Atkins, Charles N."
<Charles.Atkins@morganstanley.com>

To "Tashman, Eric D." <ETashman@Sidley.com>,
<tgerkemeyer@aep.com>

11/22/2011 06:48 PM

CC "Hochberg, Kevin J." <khochberg@sidley.com>, <rvhawkins@aep.com>
Subject RE: Overview of Securitization Legislation-Lowest Cost Test and Recent Securitization Legislation

I agree with Eric. The more recent statutes have not included the Texas lowest cost language...and I do have one experience in Texas where the interpretation of the language led to transaction delays...Bond structuring should not be legislated...The actual bond pricing process will be very transparent--the orders from investors for particular tranches will be clearly portrayed in the underwriter's order book.....

From: Tashman, Eric D. [mailto:ETashman@Sidley.com]

Sent: Tuesday, November 22, 2011 6:34 PM

To: tgerkemeyer@aep.com

Cc: Hochberg, Kevin J.; Atkins, Charles N. (GCM)

Subject: RE: Overview of Securitization Legislation-Lowest Cost Test and Recent Securitization Legislation

Tom: As an addendum to my commentary below, it should be noted that a lowest cost certification by the utility and/or the underwriters, while not required by statute, has been required in the recent financing orders issued in Louisiana and (of course) Texas. (The Arkansas commission did not require one, but it is an exception.) So, the

11/28/2011

requirement for the certification has been pretty universal, regardless of the language of the statute. I don't think it will be possible to argue (persuasively) that a lowest cost certification (in one form or another) in a financing order is either inappropriate or uncommon. I think the argument is merely about whether the lowest cost standard needs to be in the statute, or whether it is best to leave it to the discretion of the Commission to implement in the financing order. Charles may have some additional thoughts. Eric

From: Tashman, Eric D.
Sent: Monday, November 21, 2011 12:59 PM
To: tgberkemeyer@aep.com
Cc: Hochberg, Kevin J.
Subject: RE: Overview of Securitization Legislation-Lowest Cost Test and Recent Securitization Legislation

Statutory Research.

The Texas statute (originally enacted in 1999) requires the Commission, among other things, "to ensure that the structuring and marketing of the transition bonds result in the lowest transition bond charges consistent with market conditions and the terms of the financing order." Tex Utilities Code Section 39.302. This "lowest cost language" is not unique. Similar language is found in some other early stranded cost statutes (although it is framed as a Commission-required finding rather than a Commission mandate).

New Jersey (1999 stranded cost legislation, as amended in 2002): "the structuring and pricing of the bonds will assure that the customers pay the lowest transition bond charges consistent with market conditions and the terms of the [financing order]..." NJ Rev Stat 48:3-62.
The 2000 Michigan stranded cost legislation (Mich Rev Stat 460.10(1)(2)) contains similar language.

In contrast, other early stranded cost statute simply required that customer rates would be reduced if the bonds were issued. See California; Mass; Conn

SB
248

consistent with market conditions,
under
optimizing
lines 390-394

The language in the proposed Ohio legislation (H.B. Section 364-Section 4928.232(D)(2)), however, reflect the approach of more recent securitization statutes. (See **Commentary** below) The proposed Ohio legislation requires that the issuance of the bonds is "both reasonably expected to result in cost savings to customers and reasonably expected to mitigate rate impacts to customers as compared with traditional financing mechanism or traditional cost recovery methods." Language similar to the Ohio bills is found in relatively-recent securitization legislation in Florida, Arkansas, and Louisiana, as illustrated below.

Arkansas (2009):

The financing order shall determine that "the proposed structuring, expected pricing and financing costs [of the bonds] are reasonably expected to result in lower overall costs or would mitigate rate impacts to customers as compared with traditional utility financing or other traditional utility recovery methods." Ark Rev Stat. 23-20-103(a)(7).

Substantially identical language is found in 2008 Florida legislation (Fla. Rev Stat 366.8260(2)(b)(2)(b))-hurricane recovery; and 2006 and 2010 Louisiana legislation (La Rev Stat 45:1228(B) and 45:1232(B))-hurricane recovery and investment cost recovery;

Similarly, the 2005 West Virginia environmental control cost legislation required that "the proposed issuance of environmental control bonds will result in overall costs to customers of the [utility] that (1) are lower than would result from the use of traditional utility financing mechanisms; and (2) are just and reasonable." 2005 West Va legislation-West Va. Rev Stat 24-2-4e(d)(3).

Maryland's 2006 rate stabilization securitization legislation simply required that the Commission find that the total amount of revenue to be collected under [the financing order] is less than what would be recovered from customers using the company's weighted average cost of capital. Md Public Utilities Companies Article 7-526.

While Wisconsin's 2003 environmental control cost legislation did include the lowest cost language, it may have reflected the earlier time of its enactment. (The financing order will result in "lower overall costs to customers than would alternative methods of financing ..." and "the proposed structuring and expected pricing of the environmental trust bonds will result in the lowest environmental control charges") Wisconsin Rev Stat 196.027(2)(b)(1)

Commentary:

I think the trend of the most recent legislation reflects a more cooperative and flexible legislative approach towards securitization. When securitization legislation was first introduced (in the context of stranded cost recovery), there was skepticism, and even hostility, from ratepayer advocates concerning deregulation efforts and the use of securitization. The required savings test might have been an attempt by the legislatures to address these concerns. Perhaps the agitation of Fichera may also have encouraged the more stringent tests.

However, in the past decade, many ratepayer groups have become advocates (as opposed to opponents or skeptics) of securitization, as the benefits of securitization have been proven. In this more receptive atmosphere, legislatures may feel

less need to impose inflexible statutory tests that might make utilities less inclined to avail themselves of this financing tool. Further legislative efforts in recent years have addressed needs, like storm costs and rate stabilization, where rate shock, rather than cost savings, has been the driving force behind the legislation. In any event, it is safe to say that more recent securitization statutes do not contain the lowest cost test (although when Texas amended its securitization statute to permit hurricane cost recovery in 2005, it incorporated the lowest cost test from its original stranded cost legislation).

Finally, if you are going to use any of the foregoing information for testimony I need to get an associate to check the quotes and cites.

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BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In re: Petition for issuance of nuclear asset-recovery financing order, by Duke Energy Florida, Inc. d/b/a Duke Energy.

DOCKET NO. 150171-EI

DATED: SEPTEMBER 4, 2015

CORRECTED CERTIFICATE OF SERVICE

I HEREBY CERTIFY that the testimony of Paul Sutherland on behalf of the staff of the Florida Public Service Commission was electronically filed with the Office of Commission Clerk, Florida Public Service Commission, and copies were furnished to the following by electronic mail, on this 4th day of September, 2015.

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