ORAL ARGUMENT – 1/31/01
00-0936
<u>TXU ELECTRIC CO V. PUC</u>

LAWYER: As part of a complex plan for the transition to competition in the generation of electricity, the legislature chose to allow electric utilities to recover 100% of regulatory assets through securitization over a compressed 15-year time period rather than the old period extending to 40 years.

This is a statutory construction case. And I have prepared a handout, that it lays out the relevant statute with notations in the margin as to how some of those provisions are referred to by the parties.

OWEN: Let's suppose we were to hold that you do look at the assets in your 10K, you look at them in the aggregate, but we were to say that you compare them against the current regulatory regime, not the regulatory regime that existed before deregulation. What evidence do you have in the record that this would be a benefit to the ratepayers, would cost less than the way that you have to proceed it if you didn't securitize these assets?

LAWYER: The legislature answered that question for us. The legislature decided that competition was a benefit to ratepayers. And in order to move the competition, instead of doing the old 40 years with regulation, we're going to go to competition. Competition would benefit ratepayers. But in order to get these regulatory assets out of the way, we're going to allow securitization over 15 years. So they came up with two tests. One is that the total revenues over the old 40 year regulatory life have to be less. Secondly, when you get down to the compressed time period that the legislature found would be a benefit to ratepayers under competition, you have to have a statutory present value analysis that prevents return for no return assets through bond interests.

OWEN: What I'm trying to get at specifically is in two different places in (g) they talk about benefits to ratepayers absent issuance of transition bonds. Suppose we were to interpret that to mean you were to recover these transition costs other than through securitization. So don't you have to make some sort of comparison by what it's going to mean to ratepayers if you securitize verses you don't?

LAWYER: I think that's a misconstruction of the Greenberg amendment. I don't think that was the purpose of the so called tangible and quantifiable benefits language in the Greenberg amendment. Rep. Greenberg put this amendment in on the floor of the House at the very last, just before the House passed this bill. Greenberg had an earlier amendment in which she was going to reduce the amount of regulatory assets that could be securitized from 100% to 50%. She withdrew that amendment. She said, I'm satisfied with the amounts that can be securitized. That's what we're talking about here.

And she substituted the amendment which was passed, and I've shown in brackets where that amendment is in the statute, and it doesn't have anything to do with limiting the amount that can be securitized. What it's talking about when you consider that amendment as a whole and its place in the statute, is how securitization should be implemented. Once you've decided you're going to have securitization 1) the first sentence of that amendment says you have to use the proceeds of these bonds to reduce debt inequity. That will benefit ratepayers, because that will provide lower rates for the utility in the future. The second sentence, the so-called tangible and quantifiable benefits language goes further and gives the commission the authority to say which debts your going to retire.

And I might use an example from this case. _____________ wanted to securitize $1.6 billion, and in the discussions with the commission here, $800 million of that was to be used to reduce higher costs debt with low cost 7% triple A bonds. That is a tangible and quantifiable benefit to ratepayers. The other $800 million was to be used to reduce even higher costs equity, dividends that have to be paid to shareholders. That is another tangible and quantifiable debt. The tangible and quantifiable benefit language is satisfied by implementing these new provisions that are a part of the Greenberg amendment. Any notion that Rep. Greenberg was attempting to limit the amounts that could be securitized is belied by her own statements to members on the floor of the House.

HECHT: Do ratepayers benefit more under TXU's application than under the PUC's ruling or less?

LAWYER: I would say the legislature would be of the view that they would benefit less under the PUC's view because you still have these undealt with regulatory assets that are unresolved. They are going to complicate and make difficult the transition to competition.

HECHT: And you think the legislature made a policy decision that reduction of high costs debt and facilitation of competition was to be put in the equation?

LAWYER: Yes. And that's why they said one of the prices ratepayers are going to have to pay is instead of recovering these regulatory assets over 40 years, we are going to get them out of the way as soon as possible through securitization bonds with a maximum life of 15.

OWEN: Let's suppose that you did not securitize these assets. What would you do? Where would you be left?

LAWYER: We would be left with higher costs debt inequity that would continue until ultimately perhaps these regulatory assets could be recovered in the securitization true up in 2004, stranded costs true up in 2004 over an extended period that the PUC argues they haven't decided it's extent.

OWEN: But doesn't the statute guarantee that you will recover those stranded costs?

LAWYER: Recover the principle, but in the meantime we won't be rid of this higher cost debt inequity. That's the benefit of securitization.

HECHT: And if you get it back through the CTC how long would that take?

LAWYER: Who knows.

HECHT: Forty years, or?

LAWYER: Mr. Barron has argued that it could take as long as 40 years. The commissioners during the hearing said, No, we don't want it to last that long. In fact, from time to time they indicated that it probably wouldn't last any longer than the maximum 15 year life on these securitization bonds.

OWEN: What carrying charges do you have on the SFAS 109 account?

LAWYER: No return on the 109 assets.

OWEN: I'm not sure I understand what your complaint is.

LAWYER: Let me use an example. As to the 109 assets, and I think there are some confusing statements in the other side's brief about how we're going to earn a 7% return on 109 assets, that's not so. Let's say I owe $600 without interest payable over 6 years. That's pretty much what a 109 asset might be when it's added into a securitization bond. What Sen. Sibley's present value test does is we're going to reduce that $600 to its present value over the bond life, using the bond interest rate, and let's just say that instead of 100 that reduces it to 75, the 75 is all that goes into the bonds.

HECHT: And then you get interest and then you're back where you were.

LAWYER: Exactly. At the end of the game you've recovered $600 on the no return assets.

HECHT: Is that what your brief means when it says, as applied to regulatory assets that carry no return, the statutory present value test eliminates any return or recovery of bond interests on those assets by discounting them at the bond interest rate to their present value?

LAWYER: Exactly. And here in dealing with the amount to be securitized, the legislature had two tests: the total revenue test, the total amount without present value, just aggregate dollars over the 40 years has to be compared to the total amount under securitization. And if the total amount under securitization is less, you've met the test. We met the test.

OWEN: Let me try and understand though. The only regulatory assets that you're saying is not securitized under the existing financing order are the 109 assets?

LAWYER: No that's a primary amount of assets. I think there are some $1.4 billion of the 109 assets. The commission said, no we're not going to securitize them. They don't carry a return. We're going to apply a class of asset analysis.

OWEN: What other regulatory assets are there other than...

LAWYER: There are a whole list of them.

OWEN: How much dollar amount?

LAWYER: They are in the brief. They are leftover rate case expenses. There are costs that will be incurred to retire higher costs debt. Some of them carry a return. Some of them don't.

OWEN: How many of those have carrying charges over time? You say the 109 account does not.

LAWYER: The 109 does not. I think some of the others do not. Some of them do.

OWEN: So what's the harm to you? The bottom line here, what would be the harm to your company if we said, well the commission probably got this right in making you take the 109 costs through the competition transition costs as opposed to through securitization?

LAWYER: The basic harm would be that we are dealing with a rewritten statute that the legislature didn't pass. The legislature had a complex _____ of issues to deal with. And this statute involves compromises, adjustments, and a final statutory plan which satisfied hopefully all of the interested parties. Under that plan, we are entitled to securitize 100% of these assets limited only by two tests. Now you say that's not monetary harm. But I say it's letting the commission rewrite the statute. Secondly, it requires us to continue to deal with these regulatory assets on an unsecuritized basis, to pay higher costs debt inequity, and it harms ratepayers.

OWEN: In the CP&L case, had they gone forward with their CTC proceeding before or about the same time they filed their securitization filing?

LAWYER: No. I think the securitization proceeding followed their securitization filing. But there is no matching between regulatory assets and other types of stranded costs. Regulatory assets are a specific variety. They have no value in a competitive environment. Unlike stranded costs relating to plants. Those plants may have some value.

ENOCH: You have some costs that are there that under the regulated environment a consumer can pay over 40 years. Is that what I understand? In a regulated environment it could be maybe 40 years that ratepayers would pay for those?

LAWYER: Five, ten, twenty. The 109's could last as long as 40.

ENOCH: If you were permitted to sell that asset to some other individual, then you would receive less money for that because of the present value, but the person who buys that asset is relying on ultimately to get paid the full value for that 40 year investment aren't they? Since you are selling the asset, you receive less money because you're getting the present value of it. But the person that's buying the asset is buying that future value.

LAWYER: The difficulty I have is that nobody will buy these regulatory assets.

ENOCH: Unless what the state has done is say that this person is going to get that 40 years of value in 15 years. Isn't that what the bondholders get?

LAWYER: The legislature has said because we're going to move to competition instead of getting these regulatory assets which are simply debts that consumers...

ENOCH: __________________ paid for?

LAWYER: No, they haven't been paid for. Unpaid for amounts that are due to the utility arising out of prior rate cases. Instead of recovering ______ rates then, they say well let's wait awhile, we will recover those later through future rates. Now what's happened? There are going to be any future rates. So we need now to get rid of those debts.

ENOCH: But the consumer would pay for those debts with future dollars, right?

LAWYER: That's right. Over the life of the bonds.

ENOCH: The statute says this bond has to be paid in 15 years, whereas under the old regulatory system the payments could have been paid over 40 years. How do you ever get to a benefit to the consumer if all of those debts that the consumer doesn't have to pay for now, but would pay for 10 years from now, the consumer now has to pay for the whole thing in 15 years?

LAWYER: The two benefits. The legislature found ratepayers are going to be benefitted by competition. So it's fair to shift from 40 years to 15 years.

BAKER: But there has to be a measurable, tangible and quantifiable benefit.

LAWYER: And there is under the Greenberg, not as a limit to the amount you can securitize, but when you get to how you're going to implement the securitization process. You've got to retire higher cost debt inequity. And what were doing here has a precise tangible and quantifiable benefit. We're retiring high costs, 13.67% carrying costs, that the...

BAKER: But I thought you said earlier that regulatory assets not only had no value, they had no carrying costs either?

LAWYER: But we're going to include them at a discounted amount.

BAKER: Well discounted or 100%, they are still worthless and don't earn a dime. Aren't they a manufactured figure in the first place?

LAWYER: No, they are not a manufactured figure. They represent amounts that the utility paid in the past that the commission decided should be deferred for future recovery. Now there isn't going to be any future recovery.

BAKER: Is there any discussion in the briefs that this covers taxes that the utility might have to pay in the future but we're not sure, but we are going to make sure that whatever they might be you will be ready because you're getting money through the bonds and from the ratepayers?

LAWYER: There is no doubt that those taxes are going to be paid. Death and taxes. IRS is going to be there waiting for the money. The question is, when are ratepayers going to reimburse the utility for those taxes that were incurred in this prior provision of electric utility service? That will happen here because the utility now has the money from these securitization bonds. It is able to pay the taxes. They are tangible and quantifiable benefits to ratepayers because instead of the utility ratepayers paying carrying costs at 13%, they are now going to pay bond charges at 7%.

BAKER: As I understand your argument, you disagree with the asset by asset comparison method of figuring out how this scheme is going to work. Would you explain how it eliminates 75% of your regulatory assets from being securitized?

LAWYER: The asset by asset test is founded on this same tangible and quantifiable benefits language by the commission, which you understand, we say serves an entirely different purpose. It conflicts with the legislative plan. What they said is that we've got some assets that carry a 13% return. So it will be of great benefit to ratepayers if those are securitized.

BAKER: Because you reduce the carrying charges to 7%, which is the bond rate?

LAWYER: That's right. But these 109 assets don't carry any, so we're just going to disregard them altogether. Not what they should have done is net the two. Take the high and the zero and those inbetween and you come out with a net amount.

BAKER: Thirteen plus zero divided by two. Is that it?

LAWYER: No, not divided two. You add them all up and you find a composite amount of return on the regulatory assets you're going to securitize.

BAKER: Is it a correct interpretation that a utility can file an application for more than one FO?

LAWYER: Yes.

BAKER: Having said that, one of your complaints is that they only let you securitize $345 million in this first application. Is it a factual statement that you could apply two years from now for another FO to cover the $1.4 billion that you didn't get in this one?

LAWYER: We've been criticized in the briefs for failing to understand the time value of money. Believe me, we do. And your question raises the time value of money issue. The benefit is in getting this securitization now as early in the game as possible so the carrying costs that extend to 13% are reduced to a lower bond rate, and we get these regulatory assets out of the way like the legislature intended. And what the commission has done here is invent a third test, a third limit on the amount that you can securitize in the conflict with the two statutory limits. Total revenue test - less money over the old life; present value test - be sure that you don't earn any interest on a no return asset during the life of the bonds.

OWEN: If we were to decide that the commission can't look at this on an asset by asset basis, but that we would strictly apply the definition of regulatory assets, that you look at the 10K, does that make the so-called second present value test essentially disappear as an issue?

LAWYER: No, I don't think what you said would make it disappear. But what we want you to do is to make it disappear. And if anything you want to do to do that is fine with us.

OWEN: I understand that. If we were to say that you look at the 10K assets and you can't pick and choose among the 10K assets, as long as the aggregate amount that you choose out of your 10K assets meets the revenue costs test and the present value test that's in §39.301, would that effectively mean the commission can't come back and then say well, then you take that aggregate and do another present value determination of that aggregate?

LAWYER: I don't think it would prevent the commission, if I understand the way you've outlined it, from saying this tangible and quantifiable benefits language still authorizes us to come up with a third limit, and we wouldn't get all of our money.

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RESPONDENT

BARRON: I want to focus specifically on the statutory language, and then on the legislative history. Before I do so as a preference, I want to make very clear what TXU's proposal was here with respect to those 109 assets, which make up $1.4 billion on its accounting books. It was proposing to securitize them when they were earning no return, or scheduled at the time or currently are scheduled at the time to be recovered as those taxes became due over a 40 year period, and to securitize them and allow the company to get all of that money immediately by issuing those bonds.

HECHT: But they say they are discounting it at present value?

BARRON: They are not discounting it at present value. They want all that - they did the present value. They made the present value cap calculation. Yes. And they want all that money immediately. And the consequence would be to have the ratepayers pay at a 7 - 8.5% interest rate money on those bonds when they were paying no return.

There is no question in this record that there is going to be that return from the ratepayer's perspective that will now have to be paid. TXU's witness, Mosley, at administrative hearing transcript 170-171 recognized that.

OWEN: But if we look at the assets in the aggregate, TXU is also giving up a higher rate of return than it is going to get on these bonds.

BARRON: If you look at these assets, the commission did not look at these assets.

OWEN: But if we were to do that.

BARRON: I think if you were to determine that the statute, although it doesn't say aggregate, require the commission to look at it on an aggregate basis, then the case would have to be remanded for the commission to do that analysis. Colleges have argued in their brief based on the record here that the net effect in terms of interest paid by ratepayers is to make their aggregate assets go from what is currently a 2.5% interest being paid up to 5.5%. So on an aggregate basis, they lose anyway. But that is a matter the commission would need to reach on remand.

HECHT: We need to know the effect of this. And with all due regard to the lawyers in the case, there is still some confusion here. The sentence I read from the appellant's brief: as applied to regulatory assets that carry no return, the statutory present value test eliminates any return or recovery of bond interests on those assets by discounting them at the bond interest rate to their present value. You disagree with that?

BARRON: I disagree with that.

HECHT: But why is that?

BARRON: Because from the ratepayer's perspective they will no longer be paying zero return, which is an admitted fact in this record, they will be paying what the bond interest rate will be, and that remains to be seen, but the range was from 7-8.5%.

HECHT: Will they be paying it on a lower number is my question?

BARRON: I don't believe so.

HECHT: Do they add up the 40 years?

BARRON: Yes. Under TXU's calculation it would be on a $1.7 billion, which is what their present value calculation ________ in the last two sentences amounts to. The commission's calculation was $1.1 - 1.2. And there is a disagreement about what figures are used in that. But that's what they would be getting immediately, and that is the amount that the ratepayers would be paying.

The language of the statute, I think everyone can agree by its terms tells the commission that it must perform a comparison of two alternative financing packages. The tangible and quantifiable benefits standards states that the commission shall insure that securitization, issuance of transition bonds, shall provide tangible and quantifiable benefits greater than the absence. Without absence of transition bonds. Without securitization. That's what the statute says. It was incumbent on the commission under the plain language of this statute to analyze the proposed financing package and see whether it provides tangible and quantifiable benefits to ratepayers.

HECHT: But did that analysis include the benefits of competition, the speedier competition, and the lower debt costs over time, or did they just say that's not quantifiable?

BARRON: The commission listened - there was no testimony per se about the abstract value of competition. But there was testimony from TXU witness, Mosley, about how paying down higher debt would provide benefits. But it amounted literally two or three sentences in which the witness said that by getting this money, we will be able to apply it, that will reduce our costs of capital and that will allow the commission in future cases to set lower transmission distribution rates.

There was no explanation of how it is that paying down generation costs is necessarily going to translate into a lower costs of capital where the unbundled transmission and distribution utility and whether there will be lower rates in fact for the utility. The witness simply did no expand at all. It becomes a question of the weight of the testimony in that instance and the credibility of the testimony. The evidence just wasn't there that it really resulted in tangible and quantifiable benefits.

OWEN: You're saying comparison between securitization verses going through the other mechanism, which is the CTC?

BARRON: Yes, unsecuritized.

OWEN: With all due respect, it seems like you're trying to get those words to carry an awful lot of water. If they had wanted to say you compare securitization with CTC and pick the one that gives you the rights pairs, the best benefits, why didn't they just say that?

BARRON: Well they could have, and it's ambiguous. But what the statute definitely says is compare it with absence the issuance of transition bonds. That's absence of the securitization transition bonds.

OWEN: Another place in the statute, I believe it's back in (f) they say you get to do it either of two ways and the utility gets to pick. It seems like to me that what you're arguing you is the utility doesn't really get to pick.

BARRON: The utility gets to pick, but it must satisfy the standards that §39.303(a) says: there's got to be a finding by the commission that it meets the pro________ use test and the other standards in _________.

OWEN: Does that mean you have to get to the end of the CTC proceeding before you can issue a securitization order?

BARRON: No, because one was issued here and one was issued in other cases. In this instance, the commission in order to decide what the proper comparison period was had to look at what the record presented. And what the record presented here at this time that TXU chose to file its application was that these assets were scheduled to be recovered over a 40 year period, and that was the appropriate comparison.

OWEN: But not under the CTC because we don't know what...

BARRON: We don't know yet.

OWEN: So you're basically saying the utility has to do something under the statute that's impossible?

BARRON: No, not impossible. If the utility chooses to file immediately, it must accept what the current recovery period is. And that as Mosley himself said in the comparison he made albeit on a nominal basis was 40 years compared to 12 years.

OWEN: Doesn't the statutory scheme indicate that they are encouraging utilities to file sooner rather than later for securitization, because they've put short time limits. They say once the utility files, the commission has only X number of days to act, there's no CA review, they tell us to expedite it. That seems to me that they are not saying that the utility needs to wait until its CTC costs are all put to rest, and then file securitization.

BARRON: But it's not a blank ticket. It's got to be shown to benefit ratepayers tangible and quantifiable benefits. And what the statute does not define is how the commission should go about measuring tangible and quantifiable benefits how it should do a comparison, and if the commission reasonably chose in this instance to make that comparison on a present value basis. It works perfectly with the present value calculation of the cost of a cap, of the cost for securitization that are made in the last two sentences of 39.301. That's a calculation of how much it's going to cost on a present value basis to do a securitization financing.

OWEN: But again, all that hinges on the ability of the commission to take these assets piece by piece rather than following the definition of regulatory assets. It's just saying you take the assets out of the 10K, out of that box in the 10K, and apply the test in 39.301.

BARRON: Well the statute - the commission could apply that present value comparison either on an aggregate basis or on an asset by asset basis.

OWEN: ________ do it on an aggregate basis here.

BARRON: It did not.

OWEN: What would the result have been had it done so?

BARRON: That, the commission did not address and I could not say whether it would be beneficial or not. Other parties have argued in their briefs that it would not be beneficial even if you did the analysis on an aggregate basis.

BAKER: Isn't it inconsistent to do one thing here with TXU asset by asset and then CPL do an aggregate?

BARRON: It would be if that's what happened, but that's not what happened. There was no aggregate analysis in the sense that it is being talked about here, a box taking the lump sum of the total assets, and doing that analysis. That is not what happened in the CPL case. The only aggregation, and it's a misuse of the term aggregation, is that the commission when there were bricks and mortar assets, regulatory assets, that...

BAKER: But bricks and mortars that's not a regulatory assets is it by definition?

BARRON: No. When it gave rise to the tax asset, the 109 asset, then the commission analyzed those two together in the CPL case. But those kinds of assets, the 109 assets here in the TXU case, were unrelated to any of the bricks and mortar that were part of this application. And so that's consistent with what the commission did in CPL where it only allowed securitization having shown a benefit of the 109 assets that were related to other assets there, and analyzed them together. It did not allow 109...

OWEN: Did CPL ask to securitize 109 assets that were not specifically tied to bricks and mortar?

BARRON: Its original application was for all of them.

OWEN: Did it withdraw that request?

BARRON: There was a settlement in which it proposed to securitize only the ones that were specifically...

OWEN: So that really didn't get to be an issue in the CP&L case?

BARRON: That's right. The commission acted consistently in that case. The question of aggregation wasn't an issue presented in that case before the commission.

OWEN: In the CP&L case they included bricks and mortar assets that had 109 taxed to them. Had those bricks and mortar assets gone through the CTC proceeding before the financing order was issued?

BARRON: I don't believe so. And the reason that the commission could do it in that instance is when you have some of those underlying assets in the proceeding to be securitized, you know what the recovery period is going to be. If you allow those it will be a 15-year period, and therefore, the related taxes will come due within the 15 year period.

OWEN: You know there will be a 15 year period because?

BARRON: If they are to be securitized, it would be the...

OWEN: I thought you said the bricks and mortar assets were not securitized.

BARRON: I'm sorry. Bricks and mortar I'm using too broadly. There are some assets that were related to the tax assets that were properly the subject of the securitization application. And the commission analyzed those two together to see whether there would be a benefit and found that there would be.

OWEN: So there were no dollars in the 109 account that related to assets that would go through the CTC, is that what you're saying?

BARRON: Yes. Assets that were also the subject of the securitization application in the

TXU case.

OWEN: They were or were not?

BARRON: Were not.

OWEN: So you would still have to determine the CTC how and when those costs would be recovered?

BARRON: Yes, they would have to make that determination for those other costs.

OWEN: And the 109 account that goes with that. I don't see why we don't have the same problem here that we did in CP&L.

BARRON: In both cases with respect to the 109 assets that relate only to other stranded costs that are not part of the securitization application, the commission had to make a judgment under the statute about what the recovery period would be for comparison purposes to show would there would be benefits.

The commission decided that it would use for purposes of analysis the existing recovery period absent securitization, which may or may not change later down the line after the conclusion of the CTC proceeding. That may be a shortened period. And at that time, TXU could come back and seek to securitize based on a known securitization. But the commission was not required to guess about what the outcome of that other proceeding might be. It had to take what the recovery period was absent securitization at the time. And the statute provides for a rate freeze at the time that continued to have a 40 year recovery period.

I think that the most important part of that legislative history comes in the way that Greenberg adds this amendment. Because it provides evidence that the tangible and quantifiable benefits comparison may act as a real standard, a potential constraint on the amount that may be securitized. When she introduced that amendment, she amended it. The statute as it existed before she amended it was a sentence - the present value cap, and another sentence from the Sibley amendment that said, the savings associated with the securitization shall work to the benefit of ratepayers. She initially proposed to amend that by saying, adding the words "the commission shall insure that the savings associated with securitization shall work for the benefit of ratepayers," and she would have crossed through the 100% potentially ___________ recovered regulatory assets and made them 50%. She would have crossed through the 75% of other stranded costs and made them 25%.

But the next day on the House floor, she withdrew that amendment or amended her amendment and said, we don't need to change the rigid reductions, the amount potentially eligible in 2.01. Instead, and in place of the savings associated shall accrue, she inserted her amendment that had the tangible and quantifiable benefits language that the commission shall insure that securitization provides tangible and quantifiable benefits. The commission had to make that evaluation. It is true that unlike the New Jersey statute, there is not a list of what those specific tangible and quantifiable benefits are. But our view is that the absence of that reasonably gives what the court said in State v. PUC when it was looking at limits of the commission's authority for deferred accounting that the commission as an agency created to centralize expertise is to be given a large degree of latitude in the methods that it uses to accomplish the regulatory function.

HECHT: But the trouble I have with that is that if you go from a statute that is fairly well set out and you add a phrase, and the PUC's position now is that that basically lets us do the right thing and be fair and maybe restrike the deal that the legislature made to get here in the first place.

BARRON: The deal that was struck cannot stop with the Sibley amendment. I think you've got to look hard at that language - the tangible and quantifiable comparison. Put yourself in the commissioner's shoes and say we have to make a comparison. We've got to compare the cost for the securitization, the cost without. What is a reasonable way to do it? The overwhelming weight of the testimony said, But once you've calculated the cost of securitization on a present value basis, as you are required to do to establish a cap, it only makes sense. And it's the only credible way to do an economic analysis to compare with the present value absence securitization.

HECHT: But if these are securitized now, can't the PUC come back in 2004 or at other true up periods and redetermine whether the ratepayers are really getting benefitted or not, and make adjustments or not?

BARRON: The commission has a limited ability to made adjustments. It cannot touch whatever amount has been securitized.

HECHT: But that's to protect the bond holder.

BARRON: That's all.

HECHT: But what the utility does with them that can be touched.

BARRON: Perhaps so.

HECHT: Why else tell them to come back?

BARRON: The reason to come back is because the commission is now conducting proceedings to estimate the remainder of the stranded costs other than regulatory assets, which it is required to do. And those estimates will culminate in a final true up, a final decision to try to make sure that the utility recovers all of its stranded costs, including regulatory assets, but not over recover those stranded costs.

To answer your question, the commission has limited authority to make adjustments if it finds that there is, for example, an under recovery in the event that too much has been authorized to be securitized up front. But there are constraints on what must be done. That's under 2.01(a).

OWEN: But the true ups occur under 39.307, and they occur at least annually, not after 2.04.

BARRON: Two different true ups. The statute uses the word twice. Under 39.307 we're talking about an annual true up to make sure that any over recoveries or under recoveries on the bonds there's enough to pay the bonds. That's a different concept altogether from the filed true up of the utility's total stranded costs at the end of the day. That's a separate proceeding under 39.262.

OWEN: But if they over securitize these 109 assets, is there anything the commission can do about it post 2004?

BARRON: It has some authority to do something, but it's constrained authority.

OWEN: What can it do after 2004? What could they do if there was over securitization of 109 assets?

BARRON: If there was an over securitization of 109 assets, they could not do anything about the fact that they were securitized. If it turns out - and the provision I was searching for was 39.201(l), which makes clear you can't touch anything that's securitized. There is limited opportunity for the commission to do other things like reverse depreciation expenses that's been used to reduce stranded costs. It can adjust the utility's transmission distribution rates within reasonable limits. And that sort of thing. So there is an avenue to make adjustment. But it's constrained by the fact that once securitization has been allowed that can't be dealt with at all. It's got to be to the extent that there is other play with respect to the other stranded costs when a final determination is made.

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LAWYER: I want to followup on the question about what happens if these assets were perhaps fully securitized, $1.6 billion and, yet, it is ultimately determined that this utility has no stranded costs. In fact, they may be negative. And the problem with the 2.01(l) language is there is no specific provision. Once the assets are securitized, the bondholders have a direct claim against the ratepayers who are continuing to make these charges. And that cannot be circumvented and that is as it should be.

The problem is, how do those ratepayers get back what they have been committed to pay through the securitization process?

HECHT: Rebate from the utility.

LAWYER: The question is, whether or not the generating company or the parent company can be compelled by the commission to pay the transmission and distribution company? And there is no language in 2.01(l) that provides for that. The commission has informally from the bench indicated they believe that they have that power. Our concern is that over securitization needs to be considered in the overall context of claims for stranded costs. This bill was passed on the assumption by the legislature and by the utility companies that there would be massive stranded costs. As we all know, the utility markets, the electricity markets, energy markets are volatile, and they've changed radically since this legislation was passed.

When natural gas is at $8, or $9, or $6 or even $4, the stranded cost equation changes radically. Nuclear plants, lignite plants, coal plants that are high capital cost plants that arguably resulted in stranded costs now are much more valuable. And there may not be any stranded costs. I believe, and my client strongly believes that the commission took the cautious and the conservative approach. As was indicated by the previous questions there are other opportunities for this utility to securitize. We get another look at this at 2004. We have another opportunity to securitize. This commission said, let's take this a step at a time, let's be cautious, let's be conservative...

HECHT: But the monetary markets may be as flexible as the fuel markets, and 2004 bonds are high priced and this won't make any sense.

LAWYER: And I think the point is that the commission needs the flexibility and the legislature has provided the flexibility in this statute to take this step by step and try as best they can to accommodate all of this volatility.

OWEN: And that's my question. The only language I can glean so far that you say gives the commission this flexibility is the language about tangible benefits. That's the only place it appears embedded in two paragraphs in (g). Is there any other statutory language that you can say gives the commission all this broad authority?

LAWYER: No. But I must say, and I want to agree with Mr. Barron, that if the court will look carefully at the legislative development here and take this step by step beginning in the Senate, what you will find is a steady restriction in securitization, a steady expression in this language of skepticism about securitization. If this language had been left as it was in the bill when it passed the senate, we would not be here. But what happened was, there was a steady restriction. Ultimately Rep. Greenberg said, listen I think ratepayers ought to benefit.

OWEN: We've got a regulatory assets definition that says you take it out of their 10K basically. It says which assets you look at. Where I have trouble is, once we say that the commission can pick and choose among these assets, what stops the commission from taking these assets one by one and saying, Well we just think you ought to take all these assets through the CTC process and not through securitization, and we're going to come up with whatever test we think is appropriate at the time to measure what's tangible and quantifiable such that no assets within the commission's discretion are ever securitized?

LAWYER: Both in CPL and in the TXU case they've made significant determinations of assets that are...

OWEN: Because they chose to do so. If we were to construe the statute as broadly as you want us to, doesn't that give the commission carte blanche on whether to decide if any assets are securitized?

LAWYER: What they applied in connection with the tangible and quantifiable benefits test is a traditional accepted routine present value analysis. I don't believe there is any stretch. Mr. Barron says that the commission has invented tests. They had expert testimony that said, when you look at tangible and quantifiable benefits a traditional present value analysis is appropriate. That's not picking and choosing at random.

OWEN: But how do we know that they will apply that test in the future, because they could say, well that's not really the test. We found it appropriate in this case but we can define tangible and quantifiable in any way that we see fit. So we may pick a different test in a different case to arrive at quantifiable and tangible, so that we are the ultimate arbiter of what regulatory assets get securitized. And that's my concern. If we construe the statute the way you want us to, that we are giving the commission a tremendous amount of discretion that the statute doesn't otherwise seem to give them.

LAWYER: I would assert that it is in the essence a regulation that a commission has necessarily reasonable discretion, not arbitrary, not capricious. But they have to have discretion particularly in a deregulation market as volatile as these circumstances are. If they had not had solid, almost unanimous expert testimony about what an appropriate interpretation of quantifiable and tangible benefits were, which if you look at this record there is not a significant - I don't think you can draw a conclusion that they have been arbitrary or capricious. I think they've exercised the flexibility that the legislature, I believe, thankfully gave them, and I think they need to continue to do that.

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REBUTTAL

LAWYER: This is a statutory construction case. It doesn't make any difference what somebody testified to, what they thought this might mean of the commission, or whether they testified to this or that. The question here is the proper construction of statutory provisions which I've tried to lay out in front of you. This court has always made an effort to determine and give effect to the legislature's intent. You look first to the language, but you also consider the legislative history, the nature and object to be obtained, and the consequences that would follow from alternative constructions.

Justice Enoch in the GTE case said that the commission has no inherent authority. Certainly, you look at the commission's construction, but you're not bound by it. The buck stops here in terms of construing the statute.

OWEN: Explain to me one more time what evidence you put in the record that you say demonstrates quantifiable and tangible benefits of including the 109 assets in the securitized assets.

LAWYER: We're passing in the night on that one, because the 109 assets are either included or they are not included because as the result of the two statutory tests that limit the amount you can securitize.

OWEN: Assuming we include the 109 assets, you meet both of the tests or the last part of 3.01, what evidence do you have that it still provides a quantifiable and tangible asset to ratepayers?

LAWYER: We reduced the assets we wanted to quantify by $285 million, which sounds fairly tangible and fairly quantifiable.

OWEN: So if these aren't securitized, you will seek to include those assets in CTC?

LAWYER: Those will not be on the books anymore. $1.865 billion.

OWEN: But if this securitization order fails for whatever reason, would you take those assets that you were going to write off, and now charge those to ratepayers through CTC or some other method?

LAWYER: That would be the effect of continuing the existing regime. The ratepayers are going to continue to pay on that $285 million, and they are going to continue to pay on the whole package at higher interest costs. That's why in this handout you can see the statute. It begins by saying, you can securitize 100% of these things right off. Sept. 1, 1999, the effective date of the act. Let's get it done in 90 days. Let's have accelerated appellate review. Why? Because securitization is a win, win situation. It benefits the utility. It benefits ratepayers. I sometimes wonder why we're arguing about this.

HECHT: That's what we're wondering. Your opponents vehemently disagree.

LAWYER: Yes, they vehemently disagree with a lot of things that the utility has proposed. Maybe they've fallen into a rut. I don't know.

One of the canons of statutory construction when you're looking at two alternatives, is which one makes sense, which one creates problems. If you go with TXU's construction, you have two and only two statutory limits plainly stated in the statute making it plain that the legislature knew how to use present value when it intended it. It knew how to use total revenues when it intended that. Those are the only limits. Then you have provisions that talk about how securitization would be implemented. What are you going to do with this money? You use it to reduce debt. And the PUC has to be sure they are tangible and quantifiable benefits from the securitization.

PHILLIPS: You can't predict the financial market well enough to know over a 40-year payout it might take to do all of this, whether or not that's better or worse for ratepayers as a whole than securitizing it can you? There's too many variables in this.

LAWYER: Which gets me to the point that I want to make here. And that is, that our construction of the statute makes sense. It doesn't create problems. It's easy to implement. It's something the PUC could have done within 90 days and we've been behind it. The problems arise when you start trying to give this tangible and quantifiable benefits language a purpose beyond what it was intended. It was not intended to be a limit on the amount you can securitize. It's only a direction to the commission to be sure that you implement the securitization in a way that will provide benefits.

PHILLIPS: Do you reject the interpretation of the legislative history that Rep. Greenberg thought this was a good as a 75/25 limit over in 39.201?

LAWYER: I can't believe Rep. Greenberg intended that, because she said she was satisfied with the amount. And all she wanted to do now was to be sure that the benefits from securitization, that is reducing the debt, go to ratepayers. That's what this language does. It doesn't provide another limit on the amount.

PHILLIPS: But you can't really assure us of that, because you don't really know.

LAWYER: We don't really know. All we can do is to look at the statute and when you look at the statute it says, securitize 100% quickly. These are the only two plain limits, the total revenue test, specifically present value test. The language about tangible and quantifiable benefits relates to how securitization is to be implemented. And if you apply a 40-year test out of that language this time around, maybe some other test the next time, that conflicts with the statutory total revenue test, which says over 40 years you simply look at the total revenues. And over the life of the bonds, you reduce by a discount to obviate any return of interest over the life of the bonds.

What the PUC is arguing here is that the legislature should not have disregarded the old 40 year test. And in order to provide tangible and quantifiable benefits they should have required a present value test over 40 years. If there's anything plain from this statute, the legislature didn't do that.