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INDIANA UTILITY
REGULATORY COMMISSION

**SOUTHERN INDIANA GAS AND ELECTRIC COMPANY
d/b/a CENTERPOINT ENERGY INDIANA SOUTH
(CEI SOUTH)**

**DIRECT TESTIMONY
OF
ERIC K. CHANG
MANAGING DIRECTOR, SECURITIZED PRODUCTS ORIGINATION, BARCLAYS
CAPITAL INC.**

ON

OVERVIEW OF SECURITIZATION AND RELATED CONSIDERATIONS

PETITIONER'S EXHIBIT NO. 3

DIRECT TESTIMONY OF ERIC K. CHANG

1 **I. INTRODUCTION**

2

3 **Q. Please state your name, business address and current employment position.**

4 A. My name is Eric K. Chang. My business address is 745 Seventh Avenue, New York,
5 New York, 10019. I am a Managing Director in the Securitized Products Origination
6 group at Barclays Capital Inc. ("Barclays").

7

8 **Q. On whose behalf are you submitting this direct testimony?**

9 A. I am submitting testimony on behalf of Southern Indiana Gas and Electric Company
10 d/b/a CenterPoint Energy Indiana South ("CEI South", "Petitioner", or "Company"),
11 which is an indirect subsidiary of CenterPoint Energy, Inc.

12

13 **Q. Please describe your role with respect to Petitioner CEI South?**

14 A. Barclays has been engaged by CEI South as financial advisor and banking witness in
15 connection with CEI South's review and assessment of various rating agency and
16 capital markets considerations related to the contemplated securitization issuance and
17 its application to the Indiana Utility Regulatory Commission (the "Commission") for a
18 financing order authorizing the securitization.

19

20 **Q. Please describe your educational background and professional experience.**

21 A. I graduated from New York University Stern School of Business with a B.A. in Finance
22 and a B.A. in Marketing. My relevant professional experience includes working
23 approximately 17 years in the securitization industry. From 2005 – 2011, I was
24 employed at Bank of America Merrill Lynch as a securitization banker and executed
25 asset-backed securities transactions across consumer asset classes. Since 2011, I
26 have been employed at Barclays as a securitization originator and banker focused on
27 a broad range of consumer asset classes, including utility securitizations.

28

29 **Q. Have you ever testified before the Commission or any other state regulatory
30 commission?**

31 A. Yes. I have testified before the Public Utilities Commission of the State of California in
32 Southern California Edison Company's application for authority to securitize certain

1 costs and expenses pursuant to California Public Utilities Code section 850(a)(2). I
2 have also testified before the Public Service Commission of Wisconsin in the
3 application of Wisconsin Electric Power Company for a financing order authorizing the
4 issuance of environmental trust bonds pursuant to Wisconsin Statutes Section
5 196.027.

6

7

8 **II. PURPOSE AND SCOPE OF TESTIMONY**

9

10 **Q. What is the purpose of your testimony in this proceeding?**

11 A. The purpose of my testimony is to: (i) provide a brief history and overview of the
12 securitization market; (ii) describe key structural and security features of utility and
13 non-utility securitizations; (iii) discuss structuring, sale, and pricing considerations of
14 utility and non-utility securitizations; (iv) describe the rating agency process and
15 considerations for utility securitizations; (v) describe the marketing process for utility
16 securitizations; (vi) describe the costs of issuance associated with utility securitizations
17 generally, and specifically the estimated costs for CEI South's first securitization bond
18 issuance; and (vii) provide concluding remarks to the testimony.

19

20 **Q. Are you sponsoring any attachments in this proceeding?**

21 A. No, I am not sponsoring any attachments in this proceeding.

22

23

24 **III. SECURITIZATION BACKGROUND AND OVERVIEW OF THE SECURITIZATION**
25 **MARKET**

26

27 **Q. Please provide a brief description of securitization.**

28 A. Securitization is the process of financing cash flows from a specific asset or pool of
29 assets, and issuing claims on these assets, through the issuance of asset-backed
30 securities ("ABS"). These securities rely solely on the cash flow stream generated by
31 the underlying asset or pool of assets, and not by the credit of the originating company.
32 For utility securitizations, the asset is the right of a utility to bill and collect a special
33 tariff or surcharge paid by the utility's customers in its service territory, as will be

1 described in further detail in this testimony. As a result, a securitization's credit quality
2 and ratings reflect the predictability or volatility of that associated cash flow, and the
3 securitization is able to achieve higher credit ratings (of which the highest rating is
4 AAA(sf)) than the originating company and attractive financing costs.

5

6 **Q. Please provide a brief history and description of the securitization, and more**
7 **specifically the utility securitization, market.**

8 A. Since the first public securitizations were issued in the 1970s, the securitization market
9 has expanded in both size¹ and in the number of asset classes that have been
10 securitized, with the ABS market being seen as an important, well established and
11 efficient means to raise debt financing for companies across various industries and
12 asset classes. Common consumer ABS asset classes that are securitized include
13 credit card debt, auto loans and leases, equipment loans and leases, student loans,
14 and consumer personal loans.

15

16 The securitization market has remained steady since the financial crisis, with issuance
17 volumes peaking at \$298 billion in 2021, a post-Great Financial Crisis high and 55%
18 higher than new issue volume in 2020 (\$192 billion) as shown in Table EKC-1 below.
19 Although the spread of the COVID-19 virus had a short term negative impact on the
20 new issuance pipeline for securitizations, with no ABS issuances from March 11th until
21 April 14th 2020, the securitization market re-opened to significant investor demand and
22 the remainder of 2020 saw significant growth momentum from both issuers and
23 investors. The typical non-utility securitization size can range from approximately \$200
24 million to greater than \$2.0 billion with a number of large historical transactions in the
25 standard (non-utility) ABS market.

¹ See Table EKC-1 for details on ABS issuance volume by asset class.

Table EKC-1- Historical U.S. ABS (2016-2021)

2016		2017	
Asset Class	Volume (\$ Billions)	Asset Class	Volume (\$ Billions)
Auto	87.21	Auto	94.24
Consumer Loan	9.42	Consumer Loan	12.45
Credit Cards	34.61	Credit Cards	47.23
Equipment	10.33	Equipment	12.28
Other / Esoteric	35.14	Other / Esoteric	46.34
Student Loan	14.57	Student Loan	15.85
Total	191.27	Total	228.38
2018		2019	
Asset Class	Volume (\$ Billions)	Asset Class	Volume (\$ Billions)
Auto	103.02	Auto	109.31
Consumer Loan	11.38	Consumer Loan	15.13
Credit Cards	36.56	Credit Cards	24.26
Equipment	14.23	Equipment	19.58
Other / Esoteric	56.43	Other / Esoteric	54.58
Student Loan	18.39	Student Loan	13.5
Total	240.01	Total	236.36
2020		2021	
Asset Class	Volume (\$ Billions)	Asset Class	Volume (\$ Billions)
Auto	96.2	Auto	124.28
Consumer Loan	10.43	Consumer Loan	18.75
Credit Cards	3.78	Credit Cards	17.51
Equipment	12.98	Equipment	19.46
Other / Esoteric	52.21	Other / Esoteric	92.59
Student Loan	16.42	Student Loan	25.42
Total	192.02	Total	298.01

Source: Bloomberg and Barclays

1

2 Utility securitizations first came to market in the mid-1990s with Puget Sound Power
3 and Light Company ("Puget") issuing the first utility securitization in 1995 with \$202
4 million of pass-through certificates to recover conservation expenditures approved by
5 the Washington Utilities & Transportation Commission. The bonds were secured by
6 Puget's right to bill and collect special surcharges from its customers to recover the
7 approved conservation expenditures.

8

9 As shown in Table EKC-2 below, across 83 transactions, over \$62 billion of utility
10 securitization bonds have been issued successfully in the ABS market by electric utility
11 companies across the country as of May 3rd, 2022. Utility securitizations have ranged

1 from approximately \$22 million to \$4 billion² in offered size since the sector began in
2 1995.

3
4 Calendar year 2021 saw an increase of utility securitizations, totaling just over \$2.3
5 billion over 5 deals. In February of 2021, Southern California Edison ("SCE") issued
6 approximately \$338 million across three tranches of utility cost recovery bonds to
7 recover the costs and expenses related to catastrophic wildfires, the first utility
8 securitization transaction since 2019. Wisconsin Electric Power Company issued one
9 tranche of environmental trust bonds for approximately \$119 million in May of 2021.
10 These bonds were issued to recover the cost and expenses related to the
11 undepreciated cost of environmental control activities at a retired power plant. In
12 November of 2021, Pacific Gas and Electric Company ("PG&E") issued three tranches
13 of recovery bonds totaling approximately \$860 million to recover fire risk mitigation
14 expenditures. The last utility securitizations issued in 2021 were both issued on behalf
15 of Duke Energy in November of 2021 for a combined size of over \$1 billion. Duke
16 Energy Carolinas and Duke Energy Progress each issued a series of storm recovery
17 bonds to recoup significant storm expenditures incurred as a result of a collection of
18 hurricanes and a winter storm. Duke Energy Carolinas issued an approximately \$237
19 million deal across two tranches while Duke Energy Progress issued a three-tranche
20 transaction totaling approximately \$770 million.

21
22 The utility securitization pipeline has remained strong in 2022, with four transactions
23 having been priced as of May 3rd, 2022. In February of 2022, SCE issued its second
24 series of wildfire recovery bonds across three tranches totaling approximately \$533
25 million. Two additional utility securitization transactions priced in March of 2022. The
26 first was DTE Energy's issuance of approximately \$236 million across two tranches of
27 notes to recover costs associated with the retirement of a coal power plant and the
28 utility's tree trimming surge program. Later in March, Entergy Texas issued
29 approximately \$291 million recovery bond across two tranches, issued to recover
30 system restoration costs after power outages resulting from storms, floods or other
31 weather-related events or natural disasters. The latest utility securitization is PG&E's

² The largest utility securitization offered to date was the 1999 issuance by PEPCO totaling \$4 billion.

1 issuance of \$3.6 billion of senior secured recovery bonds in May of 2022, which
2 enables recovery and refinance of a portion of certain costs and expenses related to
3 wildfires in the 2017 calendar year.

4
5 Utility securitizations are unique, as they are supported by a “statutory credit
6 enhancement” rather than commercial or consumer assets, and are episodic, as they
7 arise to address specific financing needs of the electric utility market and have
8 historically been issued to recover costs such as rate stabilization, stranded costs,
9 pollution control costs, early retirement of rate base generation assets and storm
10 recovery costs. Accordingly, the amount of utility securitizations is unrelated to the
11 overall market capacity and investor appetite for such issuances at the time. In
12 addition, there are many examples where the utility achieved its required funding target
13 amount through multiple issuances over a period of time (e.g., Long Island Power
14 Authority in 2013, 2015, 2016, and 2017).

15
16 Utility securitizations are also a well-established asset class that are broadly
17 understood in capital markets. A diverse range of investors have participated in utility
18 securitizations to date, including domestic and international banks, money managers,
19 investment advisors, pensions funds, insurance companies, corporate cash
20 managers, and different types of trust funds. The utility securitization bonds are able
21 to receive high credit ratings even when the sponsor utility has entered into bankruptcy
22 or the rating agencies have issued a downgrade of their credit, thus justifying investors'
23 confidence in the bonds and their ability to withstand certain stressful outcomes.

Table EKC-2 - Historical U.S. Utility ABS, as of May 3, 2022

Deal No.	State	Utility	Pricing Date	Issuance (\$mm)
1	California	Pacific Gas and Electric	May 2022	3,600
2	Texas	Entergy Texas	March 2022	291
3	Michigan	DTE Electric	March 2022	236
4	California	Southern California Electric	February 2022	533
5	North Carolina	Duke Energy Progress	November 2021	770
6	North Carolina	Duke Energy Carolinas	November 2021	237
7	California	Pacific Gas and Electric	November 2021	860
8	Wisconsin	WEC Energy Group	May 2021	119
9	California	Southern California Edison	February 2021	338
10	Texas	AEP Texas	September 2019	235
11	New Hampshire	Public Service Company of New Hampshire	May 2018	635
12	New York	Long Island Power Authority	October 2017	370
13	New York	Long Island Power Authority	March 2016	469
14	Florida	Duke Energy Florida	June 2016	1,294
15	New York	Long Island Power Authority	March 2016	638
16	New York	Long Island Power Authority	October 2015	1,002
17	Louisiana	Entergy New Orleans	July 2015	99
18	Hawaii	Hawaiian Electric; Hawaii Electric Light; Maui Electric	November 2014	150
19	Louisiana	Entergy Gulf States Louisiana	July 2014	71
20	Louisiana	Entergy Louisiana	July 2014	244
21	Michigan	Consumers Energy	July 2014	378
22	New York	Long Island Power Authority	December 2013	2,022
23	West Virginia	Appalachian Power	November 2013	380
24	Ohio	Ohio Power	July 2013	267
25	Ohio	Cleveland Electric Illuminating; Ohio Edison; Toledo Edison	June 2013	445
26	Texas	AEP Texas Central	March 2012	800
27	Texas	CenterPoint Energy Houston Electric	January 2012	1,695
28	Louisiana	Entergy Louisiana	September 2011	207
29	Arkansas	Entergy Arkansas	August 2010	124
30	Louisiana	Entergy Gulf States Louisiana	July 2010	244
31	Louisiana	Entergy Louisiana	July 2010	469
32	West Virginia	Monongahela Power	December 2009	64
33	West Virginia	Potomac Edison	December 2009	22
34	Texas	CenterPoint Energy Houston Electric	November 2009	665
35	Texas	Entergy Texas	October 2009	546
36	Louisiana	Entergy Gulf States Louisiana	August 2008	278
37	Louisiana	Entergy Louisiana	July 2008	688
38	Louisiana	Cleco Power	February 2008	181
39	Texas	CenterPoint Energy Houston Electric	January 2008	488

40	Texas	Entergy Gulf States	June 2007	330
41	Maryland	Baltimore Gas and Electric	June 2007	623
42	Florida	Florida Power & Light	May 2007	652
43	West Virginia	Monongahela Power	April 2007	345
44	West Virginia	Potomac Edison	April 2007	115
45	Texas	AEP Texas Central	October 2006	1,740
46	New Jersey	Jersey Central Power & Light	August 2006	182
47	Texas	CenterPoint Energy Houston Electric	December 2005	1,851
48	California	Pacific Gas and Electric	November 2005	844
49	Pennsylvania	West Penn Power	September 2005	115
50	New Jersey	Public Service Electric and Gas	September 2005	103
51	Massachusetts	Boston Edison; Commonwealth Electric	February 2005	675
52	California	Pacific Gas and Electric	February 2005	1,888
53	New Jersey	Rockland Electric	July 2004	46
54	Connecticut	Connecticut Light and Power	June 2004	205
55	Texas	Oncor Electric Delivery	May 2004	790
56	New Jersey	Atlantic City Electric	December 2003	152
57	Texas	Oncor Electric Delivery	August 2003	500
58	New Jersey	Atlantic City Electric	December 2002	440
59	New Jersey	Jersey Central Power & Light	June 2002	320
60	Texas	Central Power and Light	January 2002	797
61	New Hampshire	Public Service of New Hampshire	January 2002	50
62	Michigan	Consumers Energy	October 2001	469
63	Texas	Reliant Energy	October 2001	749
64	Massachusetts	Western Massachusetts Electric	May 2001	155
65	New Hampshire	Public Service of New Hampshire	April 2001	525
66	Connecticut	Connecticut Light and Power	March 2001	1,438
67	Michigan	Detroit Edison	March 2001	1,750
68	Pennsylvania	PECO Energy	February 2001	805
69	New Jersey	Public Service Electric and Gas	January 2001	2,525
70	Pennsylvania	PECO Energy	April 2000	1,000
71	Pennsylvania	West Penn Power	November 1999	600
72	Pennsylvania	PP&L	July 1999	2,420
73	Massachusetts	Boston Edison	July 1999	725
74	California	Sierra Pacific Power	April 1999	24
75	Pennsylvania	PECO Energy	March 1999	4,000
76	Montana	Montana Power	December 1998	63
77	Illinois	Illinois Power	December 1998	864
78	Illinois	Commonwealth Edison	December 1998	3,400
79	California	Southern California Edison	December 1997	2,463
80	California	San Diego Gas & Electric	December 1997	658
81	California	Pacific Gas and Electric	November 1997	2,901
82	Washington	Puget Sound Energy	July 1997	35
83	Washington	Puget Sound Power & Light	June 1995	202
TOTAL				\$62,588

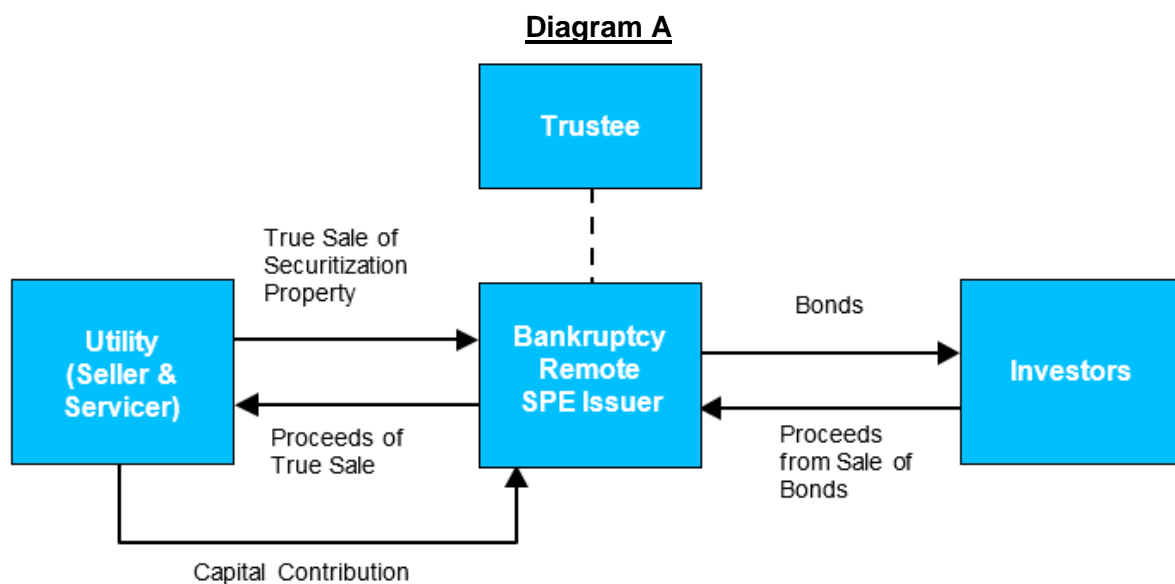
1 **IV. OVERVIEW OF THE SECURITIZATION PROCESS AND STRUCTURE**

2

3 **Q. Please describe how utility securitizations compare to the process and structure**
4 **of non-utility securitizations.**5 A. Utility securitizations follow many similar processes and principles as non-utility
6 securitizations; but, as explained in further detail later in my testimony, have certain
7 distinct features specific to the asset class.

8

9 The structure of a utility securitization is generally described in Diagram A below.



10 The asset being securitized in a utility securitization is the right of a utility to bill and
 11 collect a nonbypassable special surcharge paid by the utility's customers in the utility's
 12 service territory in an amount necessary to generate cash flow sufficient to pay the
 13 debt service of the bonds and ongoing costs of the transaction. Depending on the
 14 relevant statutory scheme, these special surcharges go by different names; this
 15 special surcharge is referred to as "Securitization Charges" in Ind. Code ch. 8-1-40.5
 16 (the "Securitization Act"). The right to bill and collect the Securitization Charges is a
 17 property right authorized and created by statute and a financing order issued by the
 18 public utility commission. In my testimony, I refer to this property right as "Securitization
 19 Property", although it oftentimes can be referred to by other names, depending upon
 20 the relevant statutory scheme. Securitization Property also includes the right to

1 periodically adjust the Securitization Charges through a true-up mechanism to ensure
2 the timely collection of Securitization Charge revenues sufficient to pay debt service
3 and ongoing costs of the securitization.
4

5 **Q. Please describe some of the legal and bankruptcy related considerations in**
6 **securitizations.**

7 A. Securitization involves the legal isolation (or “de-linking”) of the credit quality of the
8 issued securitization bonds from the credit quality of the originating company (or the
9 utility company in the case of utility securitizations). In utility securitizations, legal
10 isolation is accomplished when the utility sells the Securitization Property to a newly
11 established, non-recourse and bankruptcy-remote Special Purpose Entity (“SPE”) in a
12 transaction that represents a “true sale” for bankruptcy purposes, isolating the
13 Securitization Property from consolidation with the utility and claims by creditors of the
14 utility. This “true sale” is often statutorily authorized by the securitization legislation.
15 The de-linking process serves to protect investors from changing credit circumstances
16 or a potential bankruptcy of the utility.
17

18 The SPE then issues the securitization bonds supported by a pledge of the
19 Securitization Property (the primary collateral) and certain other limited assets of the
20 SPE (the “other collateral”) to investors (or “bondholders”). A trustee acts on behalf of
21 the bondholders, routinely making payments to the bondholders, paying Servicer fees
22 and ongoing costs, and ensuring bondholder rights, created by the statute, the
23 financing order, and the bond documents, are protected. The utility, acting as the
24 Servicer of the Securitization Property, performs routine billing, collection, and
25 reporting duties for the SPE pursuant to a Servicing Agreement between the utility and
26 the SPE. The ability to segregate the collateral in a bankruptcy-remote SPE and the
27 ability to make periodic adjustments to the Securitization Charges are critical to the
28 rating agencies’ analysis to reach the highest possible rating category (AAA (sf)), the
29 typical target rating in most utility securitizations.
30

31 The bankruptcy-remote SPE needs to have at least an independent manager and its
32 purpose and the activities in which it may engage need to be limited in the SPE’s

1 organizational documents. The SPE must deal with its utility parent on an arm's-length
2 basis to ensure that it remains bankruptcy-remote from the utility parent.

3
4 Opinions of legal counsel that the treatment of the sale of the Securitization Property
5 to the SPE is a "true sale" for bankruptcy purposes and that the SPE is bankruptcy-
6 remote (typically called a "non-consolidation" opinion) from the sponsor (utility parent
7 in utility securitizations) are vital components in most utility securitizations and, as
8 discussed below, are important considerations for the rating agencies.

9
10 The SPE can be structured so that it can issue one or more series of securitization
11 bonds in order to broaden the universe of potential purchasers of the securitization
12 bonds. I believe CEI South should maintain the flexibility to be able to form the SPE to
13 issue one or more series of securitization bonds based on market receptivity and
14 demand.

15

16 **Q. Please describe if utility securitization qualifies for off-balance sheet treatment.**

17 A. Most utility securitizations do not meet the accounting requirement for off-balance
18 sheet treatment, and are instead recognized as liabilities on the related utility's balance
19 sheet.

20

21 **Q. Please describe the structural protections in non-utility securitization**
22 **transactions and their importance.**

23 A. The structural protections put in place in a securitization transaction are an important
24 variable in the rating agency review process. A typical securitization can include
25 multiple forms of credit enhancement that enable the transaction to endure volatile
26 economic environments and achieve a higher rating. Credit enhancement may consist
27 of a combination of the following items:

- 28 - Overcollateralization: the transfer of the Securitization Property to the SPE with an
29 aggregate payment obligation that exceeds the amount necessary to repay the
30 notes;
31 - Excess spread: interest earned on the assets in excess of the interest on the notes,
32 the servicing fee, and other administrative expenses;

- 1 - Subordinate classes with lower assigned credit ratings (based on the priority of
2 principal and interest payments);
3 - Cash reserve accounts; and/or
4 - A surety bond or letter of credit provided by a highly-rated financial institution.

5

6 The total amount of credit enhancement for a particular class of notes is decided by
7 applying incremental stressful assumptions to the projected bond cash flows. In non-
8 utility securitization transactions, the senior most notes, rated AAA(sf), require the
9 highest level of credit enhancement because of the advantage of the associated
10 borrowing cost savings.

11

12 **Q. Please describe the key security features of a utility securitization.**

13 A. The key security feature in a utility securitization is a statutorily authorized “true-up
14 mechanism” or “true-up adjustment”, which is the primary form of credit enhancement
15 unique to utility securitizations. The true-up mechanism at least annually adjusts the
16 Securitization Charges billed to the utility’s customers based on projected electric
17 consumption, collections, and expected delinquencies and charge-offs. The true-up
18 mechanism ensures the estimated Securitization Charge collections match the
19 scheduled payments on the securitization bonds and related financing costs. True-
20 ups are typically required on an annual or semi-annual basis, and more frequent true-
21 ups are often permitted on an as needed basis. Because the true-up mechanism
22 allows the cash flow in a utility securitization to be adjusted to satisfy the debt service
23 of the securitization bonds and ongoing financing costs, other forms of credit
24 enhancement that are common in commercial securitizations, such as
25 overcollateralization, have generally not been required in utility securitizations.

26

27 In addition to the true-up mechanism, utility securitizations utilize a closed cash flow
28 structure, with excess cash captured and held in an excess funds account to be used
29 as a credit in the subsequent true-up adjustment.

30

31 Typically, the only other credit enhancement in a utility securitization is an equity (or
32 capital) contribution by the utility parent in the SPE which is usually limited to 0.50
33 percent of the initial aggregate principal amount of the securitization bonds. This

1 equity (or capital) may be used if available cash flow is insufficient to pay debt service
2 of the securitization bonds and ongoing costs.

3

4 **Q. Please describe some of the servicing considerations in utility and non-utility**
5 **securitizations.**

6 A. The purpose of the Servicer is to collect the payments from the underlying pool of
7 assets and transfer the collected funds to the SPE. Rating agencies are particularly
8 focused on the quality and experience of the Servicer since the process of servicing is
9 complex and requires specific knowledge relating to the underlying assets.

10

11 The servicing function in utility securitizations is a similar process to what is required
12 in other types of securitizations. In utility securitizations, the Servicer, which is initially
13 the sponsoring utility, is required to perform certain duties on behalf of the bondholders
14 pursuant to a contractual agreement between the utility and SPE known as the
15 Servicing Agreement, which includes performing billing functions and collection of the
16 Securitization Charges from customers, applying to the public utility commission for
17 periodic true-up adjustments, remitting the Securitization Charges to the bond trustee
18 (also referred to as "indenture trustee"), and providing periodic reports summarizing
19 current aspects of the transaction.

20

21 Servicing fees in utility securitizations must allow the utility to recover its costs of
22 servicing the Securitization Property. This helps ensure that the SPE can be treated
23 as bankruptcy-remote from the utility.

24

25 Servicing fees in utility securitizations are most commonly expressed as a fixed
26 percentage of the original principal balance of the transaction, which allows the
27 servicing fee to remain constant over the lifetime of the transaction. This differs from
28 most other types of securitizations where the servicing fee is expressed as a
29 percentage of the transaction's current balance, which will decrease over time as
30 transactions amortize. This difference accounts for the fact that in utility
31 securitizations, the customer base and the related servicing duties remain fairly
32 constant throughout the transaction's lifetime, whereas servicing duties decrease over
33 the lifetime of other securitizations as assets in the securitized pool are paid down.

1 Servicing fees paid with respect to recent utility securitizations have ranged between
2 0.05 percent and 0.10 percent of the initial principal balance of the securitization
3 bonds. Table EKC-3 below illustrates the servicing fee paid in recent utility
4 securitizations:

Table EKC-3: Recent Utility Securitization Annual Servicing Fee Percentages

<u>Deal</u>	<u>Date</u>	<u>Principal Amount (\$mm)</u>	<u>Annual Servicing</u>	
			<u>Fee (% of Initial Principal Balance)</u>	<u>Servicing Fee (\$mm)</u>
PCG 2022-A	May 2022	3,600.000	0.05%	1.800
ETR 2022-A	March 2022	290.850	0.10%	0.291
DTE 2022-A	March 2022	235.800	0.05%	0.118
EIX 2022-A	February 2022	533.265	0.05%	0.267
DUK 2021-A	November 2021	769.627	0.05%	0.385
DUK 2021-A	November 2021	237.210	0.05%	0.119
PCG 2021-A	November 2021	860.399	0.05%	0.430
WEPCO 2021-1	May 2021	118.814	0.05%	0.059
EIX 2021-A	February 2021	337.783	0.05%	0.169
AEPTC 2019-1	September 2019	235.282	0.10%	0.235

5 As the cost of servicing is driven more by factors such as the number of customers
6 and complexity of billing practices, servicing costs do not typically scale directly based
7 on the transaction size, and thus the servicing fee percentage for larger issuance size
8 utility securitizations tends to be lower than that for smaller issuance size utility
9 securitizations. As described in the Direct Testimony of Brett A. Jerasa, CEI South's
10 proposed servicing fee of 0.05 percent per annum of the initial principal balance of the
11 securitization bonds is consistent with the fee percentage charged in precedent
12 transactions.

1 In the event of a Servicer default, or if the Servicer is otherwise unable to carry out the
2 Servicer's duties, the bond trustee is typically allowed to appoint a replacement, or
3 Successor Servicer, for which a higher fee might have to be paid relative to the base
4 servicing fee. Replacement servicing fees in past utility securitizations have generally
5 been pre-approved up to approximately 0.60 percent of the initial principal balance in
6 the financing order to avoid any interruption in collections as a result of selecting a
7 replacement servicer. This difference in compensation reflects the potential cost and
8 difficulty of securing a replacement Servicer that is not already involved in the
9 customer billing and collection process. To date, I am not aware of any utility
10 securitization where the utility Servicer has been replaced.

11
12 **Q. Please describe some of the rating agency considerations in utility and non-**
13 **utility securitizations.**

14 A. The issuer will engage nationally recognized statistical rating organizations, otherwise
15 known as rating agencies, to evaluate the creditworthiness of the securitization and
16 provide credit ratings on specified classes of the transaction. The rating agencies
17 typically have published methodologies for major asset classes (including utility
18 securitizations) that lay out the qualitative and quantitative analysis the rating agencies
19 conduct when reviewing a transaction. The analysis conducted by the rating agencies
20 generally includes a few broad categories:

21 (1) A Review of the Originating Company as Sponsor and Servicer: The rating
22 agencies will review the originating company's background and its business
23 experience as part of their due diligence. If it is a company's first-time issuance,
24 some rating agencies may prefer an on-site visit to the company's offices to
25 receive a better understanding of the day-to-day operations of the company
26 but most have been able to transition to a virtual format since COVID-19. The
27 rating agencies will also review the company's financial statements to better
28 understand the financial state of the company. Additionally, the rating
29 agencies will review the originating company's ability to service the
30 Securitization Property.

31 (2) Analysis of the Collateral: Another part of the analysis that rating agencies
32 conduct is a review of the Securitization Property, also known as collateral.
33 The rating agencies will take into account the composition of the collateral and

1 will review the diversity of the obligor or customer base and different trends,
2 characteristics, and groupings applicable to the collateral or asset type. If the
3 rating agencies feel that the selected pool of loans for the securitization (the
4 typical collateral for a non-utility securitization) is not sufficiently diverse or are
5 overly concentrated, this may impact their assessment of the credit
6 performance of the pool of loans and the assets may not be ideal for
7 securitization. In utility securitizations, the rating agencies will conduct a review
8 of the Securitization Property, including a review for usage data, customer
9 base and forecasting, pursuant to the financing order.

10 (3) Historical Portfolio Performance Stress Analysis: The rating agencies also
11 conduct an in-depth review of the credit quality of the Securitization Property.
12 This consists of reviewing historical delinquencies and charge-offs (defaults)
13 of the company's collateral portfolio as well as other performance metrics that
14 depend on the asset class. As it pertains to utility securitizations, rating
15 agencies will also analyze historic and projected forecasts of electric
16 consumption. The rating agencies create models that will run stress scenarios
17 based on the historical and projected data to determine the strengths and
18 weaknesses of the collateral.

19 (4) A Legal Review of Transaction: The rating agencies will review the legal
20 structure of the transaction and legal opinions supporting the transaction,
21 including the legal opinions supporting the true sale and non-consolidation
22 analyses.

23
24 Similar to other types of securitizations, all major rating agencies have published
25 methodologies for assigning ratings in utility securitizations. In their review of a utility
26 securitization, the rating agencies will focus on key elements of the securitization
27 legislation, the financing order, the true-up mechanism (which ensures payment of the
28 required debt service), the nonbypassability of the Securitization Charges, and any
29 overcollateralization or other forms of credit enhancement. As the sources of payment
30 for the transaction are limited only to the Securitization Property, the rating agencies
31 will perform various "stress tests" on the cash flows (which vary by each rating agency)
32 to ascertain whether interest will be paid on time and principal will be paid by the legal
33 final maturity date. Rating Agencies' stress test analysis is most commonly focused

1 on projected vs. actual consumer consumption, delinquency, and net charge-off rates.
2 Rating agencies will also review the Securitization Charges as a percent of total
3 customer billing to ensure it is not greater than certain predetermined thresholds. A
4 more detailed description of rating agency considerations, including key features of
5 the financing order, is provided in the "Rating Agency Process" section below.
6

7 **Q. Please describe the tax and accounting considerations in utility securitizations.**

8 A. While the Securitization Property in the transaction is legally transferred to an SPE,
9 US Generally Accepted Accounting Principles ("GAAP") typically requires the
10 originator to consolidate with the SPE. Therefore, the assets and liabilities associated
11 with the securitization are consolidated with the assets and liabilities of the originator
12 for financial statement purposes.
13

14 From a tax perspective, two basic issues are typically considered when structuring a
15 securitization: 1) whether any income taxes are triggered in connection with the
16 transfer of the Securitization Property from the originator to the SPE; and 2) whether
17 any income taxes are triggered at the SPE level from the daily ongoing activities of the
18 SPE.
19

20 Securitizations are typically treated as debt for tax purposes, and the assets are
21 deemed to have been "pledged" to secure the originator's debt. The "debt for tax"
22 characterization means that the Securitization Property are still deemed to be paid by
23 the originator for tax purposes, which defers any possible immediate tax liability. For
24 securitizations, taxes are payable over time as the revenues are billed. For tax
25 purposes, the originator is treated as the owner of the Securitization Property,
26 discloses income generated by the Securitization Property, and deducts interest
27 expense payable by the SPE.
28

29 Securitizations are typically structured such that the SPE is disregarded for tax
30 purposes. This is done to avoid reductions in cash collections available to the
31 bondholders resulting from tax obligations, including the impact from any future
32 changes in tax legislation.
33

1 As in other securitization transactions, utility securitizations are designed to achieve
2 favorable "debt for tax" treatment. To achieve this result, utility securitizations are
3 structured as "Qualifying Securitization" transactions pursuant to the safe harbor
4 attributes detailed in IRS Revenue Procedure 2005-62. As a "Qualifying
5 Securitization," the creation of the Securitization Property, the transfer of Securitization
6 Property to the SPE and the issuance of securitization bonds will not cause current
7 recognition of gross income by the utility for federal income tax purposes. Instead, the
8 Securitization Charges will be recognized as income to the utility under the utility's
9 usual method of accounting.

10

11 A "Qualifying Securitization" must satisfy the following requirements: 1) the SPE must
12 be a wholly owned subsidiary of the utility capitalized with an equity interest of at least
13 0.5 percent of the initial aggregate principal amount of securitization bonds issued; 2)
14 the securitization bonds must be secured by the Securitization Property; 3) the
15 Securitization Charges must be nonbypassable and payable by customers within the
16 utility's service territory; and 4) payments on the securitization bonds must be made at
17 least on a semi-annual basis except for the initial payment period which may be longer
18 or shorter.

19

20 Treatment as a "Qualifying Securitization" within the meaning of IRS Revenue
21 Procedure 2005-62 is typically supported by an opinion of tax counsel to the
22 sponsoring utility that relies on the attributes detailed above. This is discussed in
23 further detail in the testimony of Witness Benjamin D. Vallejo.

24

25 **Q. How are debt service and ongoing costs allocated among utility customers in**
26 **utility securitizations?**

27 A. Utility securitizations have used various methods to allocate the cost of the
28 securitization (i.e., debt service and ongoing costs) among and across customer rate
29 classes. In some cases, the cost allocation methodology is dictated by the statutory
30 scheme; in others, it is a function of the historic allocation of similar costs among
31 customer classes. As a consequence, the Securitization Charges are often different
32 for each class of customers. In most utility securitizations, the Securitization Charge
33 is a consumption-based (kWh) charge, although in some instances the charge may

1 also be a function of demand (kW). If the Securitization Charges are allocated among
2 multiple classes of customers, the delinquencies in one class of customers are a cost
3 (ultimately) shared by all customers of the utility, creating "cross-collateralization" of
4 the debt service burden among all customers. This cross-collateralization is viewed
5 favorably by the rating agencies, enhancing the chance for the highest possible
6 ratings.

7

8 **Q. How are utility securitizations typically structured?**

9 A. Utility securitizations have historically been offered as amortizing structures based on
10 an established debt service amortization schedule. The date in the amortization
11 schedule where the principal of each securitization bond (or tranche of bonds) is
12 expected to be fully paid down is known as the "scheduled final maturity date". When
13 structuring a utility securitization, the targeted scheduled final maturity date can vary
14 depending on the required debt service profile. It is not guaranteed, nor is it a legal
15 obligation, for the securitization bonds to be fully paid down on the scheduled final
16 maturity date. The securitization bonds must be paid in full by the "legal final maturity
17 date", which is typically set approximately two years after the scheduled final maturity
18 date. The rating agencies rate the transactions assuming the utility securitization pays
19 off by the legal final maturity date.

20

21 **Q. What makes up the security for the securitization bonds in a utility
22 securitization?**

23 A. As stated, the principal security for a utility securitization bond is the Securitization
24 Property that is sold to the SPE, consisting of the right to impose, collect and receive
25 nonbypassable Securitization Charges from the utility's customers for amounts
26 necessary to pay principal and interest on the securitization bonds, as well as to pay
27 the ongoing costs, on time and in full. The Securitization Property includes the right
28 to adjust the Securitization Charges periodically by using the true-up adjustment
29 discussed above.

30

31 **Q. What do you mean by "nonbypassable" Securitization Charges?**

32 A. In basic terms, nonbypassable means that if a customer resides in the utility's service
33 territory, the customer must pay the Securitization Charges.

1 **Q. What is the composition of the “other collateral” component of the**
2 **securitization?**

3 A. “Other collateral” generally comprises the trust accounts established by the SPE at
4 transaction closing to be held by the bond trustee for the benefit of the bondholders.
5 These accounts and subaccounts typically consist of a “Collection Account” and
6 various subaccounts. These subaccounts will hold (i) Securitization Charge
7 remittances pending application by the bond trustee under the “waterfall” provisions of
8 the trust indenture (“General Subaccount”); (ii) the initial equity (or capital) contribution
9 by the utility discussed below (“Capital Subaccount”); and (iii) Securitization Charge
10 collections, together with earnings on the Collection Account, in excess of required
11 periodic payments of debt service and all other ongoing costs (the “Excess Funds
12 Subaccount”). Amounts in the Excess Funds Subaccount are used as a “credit” in
13 future true-up adjustments to the Securitization Charges. In some securitizations, the
14 bond trustee also creates an account to hold any Securitization Charges collected in
15 excess of the required debt service for the purpose of providing additional credit
16 support (an “Overcollateralization Subaccount”). I do not anticipate that an
17 Overcollateralization Subaccount will be required for the CEI South securitization, but
18 CEI South should have the ability to include such an account should market conditions
19 warrant.

20
21 **Q. What is the composition of the “ongoing costs” component of the**
22 **securitization?**

23 A. Generally, these ongoing costs are expenses that are incurred on an annual basis to
24 service the securitization bonds and support the operations of the SPE. These
25 ongoing costs, which must be recovered throughout the life of the securitization bonds
26 from Securitization Charge collections, generally include, but are not limited to,
27 servicing fees, administrative fees, bond trustee fees, legal and accounting fees, rating
28 agency surveillance fees, other operating expenses of the SPE, credit enhancement
29 expenses (if any) and related costs. The most significant of these costs is the servicing
30 fee. The servicing arrangement is evidenced by a Servicing Agreement between the
31 utility, as initial Servicer, and the SPE. The utility also enters into an administration
32 agreement with the SPE, under which the utility agrees to provide administrative
33 services to the SPE to support the functions of the SPE. Another ongoing cost is that

1 of the bond trustee. The servicing, administration and bond trustee fees and their
2 underlying arrangements are described in greater detail below. Ongoing costs also
3 typically include a permitted rate of return on the utility's invested capital, often equal
4 to the weighted average rate of interest payable on the securitization bonds or the
5 utility's cost of capital. This return is paid to the sponsor from Securitization Charges
6 in accordance with the waterfall established in the indenture providing for the issuance
7 of the securitization bonds.

8

9 A detailed estimation of ongoing costs for the contemplated CEI South securitization
10 bond issuance is presented in the testimony of Petitioner's Witness Jerasa.

11

12 **Q. Please generally describe the contents and purpose of a Servicing Agreement**
13 **and the role of the Servicer.**

14 A. The Servicing Agreement is an agreement between the sponsoring utility, as the initial
15 Servicer of the securitization bonds, and the SPE, as the issuer of the securitization
16 bonds. The Servicing Agreement sets forth the responsibilities and obligations of the
17 Servicer, including, among other things, billing and collecting Securitization Charges,
18 responding to customer inquiries, terminating electric service, filing for true-up
19 adjustments, and remitting collections to the bond trustee for distribution to
20 bondholders. The Servicing Agreement will prohibit the initial Servicer's ability to
21 resign as servicer unless it is unlawful for the initial servicer to continue in such a
22 capacity. In order to continue servicing the Securitization Charges without interruption,
23 the initial Servicer's resignation would not be effective until a Successor Servicer has
24 assumed its obligations. The Servicer may also be terminated from its responsibilities
25 upon a majority vote of bondholders under certain circumstances, such as the failure
26 to remit collections within a specified period of time. Any merger or consolidation of
27 the Servicer with another entity would require the merged entity to assume the
28 Servicer's obligations under the Servicing Agreement.

29

30 In exchange for its role as Servicer, the utility will be paid a servicing fee payable out
31 of Securitization Charge collections. As described earlier, ensuring there is
32 reasonable compensation to the Servicer helps to ensure the bankruptcy-remoteness
33 of the SPE from the utility. I have discussed above the customary level of servicing

1 fees for a utility securitization for the utility as well as for any replacement or Successor
2 Servicer. The estimate for CEI South's servicing fee is shown in the testimony of
3 Petitioner's Witness Jerasa. The terms of the Servicing Agreement are critical to the
4 rating agency analysis of the securitization bonds and the ability to achieve the highest
5 credit ratings. The rating agencies will be primarily concerned with the nature and
6 frequency of the true-up adjustments to be performed by the Servicer. They will want
7 to see that true-up adjustments are required to occur at least annually in the initial
8 years and more frequently (i.e., quarterly) in the last year the transaction is expected
9 to be outstanding. In addition, more frequent true-ups should be permitted if the
10 Servicer deems it necessary to pay debt service on the securitization bonds and
11 ongoing costs. The rating agencies will require that the Servicing Agreement generally
12 contemplates a Servicer's ability to remit Securitization Charges within a couple of
13 business days of receipt or posting to the utility's account.

14
15 **Q. What is the role of the Administrator?**

16 A. As described above, the securitization bonds will be issued by a bankruptcy-remote
17 SPE. The SPE will have no employees. As a consequence, the utility must provide
18 administrative services to the SPE for the SPE to function as an independent legal
19 entity. The administrative services will include, among others, maintaining general
20 accounting records, preparing all required external filings, preparing any required
21 income or other tax returns, and related support. These services are separate from
22 the servicing obligations performed by the Servicer.

23
24 To compensate the Administrator for its services and thus ensure the bankruptcy-
25 remote status of the SPE, the Administrator is paid an administration fee. CEI South
26 has proposed an estimated annual administration fee of \$75,000, plus reimbursement
27 of third-party expenses, which is in line with the general range of \$50,000 - \$100,000
28 per year for precedent utility securitizations. Table EKC-4 below illustrates the
29 administrative fee paid in recent utility securitizations:

Table EKC-4: Recent Utility Securitization Annual Administration Fees

<u>Deal</u>	<u>Date</u>	<u>Principal Amount (\$mm)</u>	<u>Annual Administration Fee (\$)</u>
PCG 2022-A	May-22	3,600.000	100,000
ETR 2022-A	Mar-22	290.850	100,000
DTE 2022-A	Mar-22	235.800	50,000
EIX 2022-A	Feb-22	533.265	50,000
DUK 2021-A	Nov-21	769.627	50,000
DUK 2021-A	Nov-21	237.210	50,000
PCG 2021-A	Nov-21	860.399	75,000
WEPCO 2021-1	May-21	118.814	75,000
EIX 2021-A	Feb-21	337.783	75,000
AEPTC 2019-1	Sep-19	235.282	100,000

1 **Q. What is the role of the bond trustee?**

2 A. The bond trustee receives and processes Securitization Charges from the Servicer,
3 calculates the amounts due to bondholders on each payment date, allocates
4 collections in accordance with the priority of payments for the transaction, invests
5 amounts on deposit in each Collection Account subaccount in eligible investments,
6 and provides periodic reports that detail account activity and balances to various
7 parties. Generally, the bond trustee operates at the direction of the Servicer, as agent
8 for the SPE.

9

10

11 **V. DESCRIPTION OF UTILITY SECURITIZATION BONDS: STRUCTURING, SALE**
12 **AND PRICING CONSIDERATIONS**

13

14 **Q. Do utility securitization bonds typically pay fixed or floating rates?**

15 A. Utility securitization bonds have traditionally paid interest on a fixed rate basis. This

1 has largely been dictated by the need to achieve predictable savings to utility
2 customers, as well as the AAA(sf) ratings typically assigned to utility securitizations
3 and the need to use complex derivative structures to achieve a floating rate.
4

5 **Q. How are the maturities and amortization structure for a securitization bond**
6 **typically determined?**

7 A. The maturity and amortization structure for utility securitizations varies based upon
8 various considerations, including statutory constraints, the nature of costs being
9 recovered, ratemaking or other regulatory considerations, and bond cash flow
10 considerations.
11

12 **Q. Please discuss whether the securitization bonds are offered in a public**
13 **transaction registered with the Securities and Exchange Commission or in a**
14 **private placement.**

15 A. Although it will depend on prevailing market conditions at the time of issuance, most
16 utility securitizations have been offered pursuant to an offering registered with the U.S.
17 Securities and Exchange Commission ("SEC"), generally referred to as a public
18 offering. Generally, public offerings are considered to be more liquid than a private
19 placement, and therefore may be more attractive to investors, which would likely lead
20 to lower overall costs for CEI South's customers. However, it may be important for the
21 utility to retain flexibility to issue the securitization bonds in a Rule 144A (pursuant to
22 the Securities Act of 1933) private placement transaction which provides for certain
23 exemptions to registration requirements, to address possible market or other
24 disruptions that may arise, such as the recent pandemic.
25

26 **Q. How are utility securitizations priced in the marketplace?**

27 A. Fixed income securities are traditionally priced to a benchmark rate index that matches
28 the weighted average life ("WAL") of the securitization bonds. Utility securitization
29 bonds have historically priced off of the mid-swap benchmark rate index. More recent
30 transactions, however, have tended to price off a treasury benchmark, including each
31 of the SCE, PG&E and Duke Energy transactions issued in 2021 and the SCE, DTE
32 Energy, Entergy Texas and PG&E transactions issued in 2022. The credit spread is
33 the incremental return required by investors over the benchmark rate to invest in a

1 specific security – in this case, the utility securitization bonds. The total yield for any
2 tranche of utility securitization bonds is the sum of (i) the benchmark rate and (ii) the
3 credit spread. These spreads are used to determine the various tranches (or
4 maturities) of securitization bonds to be offered and sold as well as their respective
5 expected and final maturity dates, to minimize the cost of borrowing.
6

7 **Q. What are the considerations taken into account when developing the tranching**
8 **structure of the utility securitization bonds?**

9 A. Both quantitative and qualitative considerations are taken into account when
10 structuring the tranching of the securitization bonds, including the:

- 11 • General market conditions at the time of pricing,
- 12 • Interest rate environment,
- 13 • Shape of the underlying benchmark yield curve,
- 14 • Perceived investor liquidity of the securitization bonds,
- 15 • General investor risk appetite,
- 16 • Investor maturity preferences,
- 17 • Competing supply in the new issue market,
- 18 • Secondary trading levels for comparable securities,
- 19 • Relative value versus comparable securities, and
- 20 • Issuance calendar in general.

21
22 The goal of the structuring process is to design a tranching structure that will appeal to
23 different classes of bond investors. Achieving that goal will increase the number of
24 investors seeking to invest in that security and, in turn, obtain a lower practicable debt
25 cost consistent with a market clearing offering, thus providing a lower total cost to the
26 utility customers.
27

28 **Q. Please discuss the implications of the interest rate environment for bond**
29 **issuance.**

30 A. Treasury yields have risen significantly since the start of 2022 on the back of
31 heightened expectations for the Federal Reserve to hike rates multiple times
32 throughout 2022 and potentially into 2023. At the same time, the Treasury curve has
33 also flattened as the rise in rates has a more substantial impact on shorter dated tenors

1 relative to longer dated tenors. The flatness of the curve is important for bond issuance
2 as it drives implications for both investor demand and the relative value of a given
3 tranche of securitization bonds. As a result, the overall interest rate environment has
4 been relatively volatile, impacting all financial instruments, including both traditional
5 debt financing and securitization bonds, and the backdrop could be materially different
6 at the time the transaction is marketed. Depending on a range of factors including
7 central bank policy and the general economic landscape, the impact on benchmarks
8 will be an important consideration for developing the final tranching structure. As
9 discussed by Petitioner's Witness Jerasa, the final details of the securitization bonds
10 would be provided in the Issuance Advice Letter submitted to the Commission after
11 pricing.

12
13
14 **VI. DESCRIPTION OF THE RATING AGENCY PROCESS**

15
16 **Q. Please describe the rating agency process for utility securitizations.**

17 A. An important component of preparing for the marketing and pricing of the securitization
18 bonds is obtaining the highest possible ratings on the securitization bonds from the
19 rating agencies. The major rating agencies all have published criteria for utility
20 securitization. The rating agency process generally consists of:

- 21 1. Preparing and distributing an initial rating agency presentation and
22 accompanied securitization bond cash flows, including cash flow stress
23 scenarios unique to each transaction.
- 24 2. Questions from each rating agency to the utility, its lead underwriter, and its
25 legal counsel, based on the initial rating agency presentation and cash flows.
- 26 3. A legal review of the transaction.
- 27 4. A servicing due diligence review.

28
29
30 **Q. Please further describe the key elements of the rating agency review process
31 for utility securitizations.**

32 A. For the initial rating agency presentation, the utility and its lead underwriter will compile
33 the key elements that each rating agency will require to facilitate its review of the

1 securitization bond financing, based on each rating agency's unique ratings
2 methodologies. The presentation will include items such as a review of the purpose
3 of the transaction, the proposed transaction structure, an analysis of the Securitization
4 Property, an analysis of historical credit losses of and write-downs on the utility's
5 receivables, forecast usage data, and an analysis of the utility's servicing and
6 forecasting capabilities. As referenced previously in Section IV, the rating agencies
7 will then conduct an analytical and qualitative assessment of the transaction as well
8 as a detailed review of the Servicer and will ask follow-on questions or request further
9 data from the utility, its lead underwriter, and its legal counsel.

10

11 Expanding on the rating agency "stress test" analysis discussed in Section IV, rating
12 agencies will perform various cash flow stress analyses, analyzing the expected
13 securitization bond cash flows under various stress test scenarios. Each rating agency
14 has its own cash flow stresses that it asks for as part of its review. These cash flow
15 stresses are generally downside and extreme scenarios to assess whether or not the
16 bonds would pay timely interest and principal by the legal final maturity date. Rating
17 agencies may ask the utility and its lead underwriter to provide additional stressed
18 cash flow outputs for further analysis. Additionally, the size and diversity of the
19 customer base, classes within the base and the size of the Securitization Charges as
20 a percent of the aggregate customer electric bill are important factors in the rating
21 agency process. Rating agencies will also review the legal integrity of the utility
22 securitization by examining the legislation and financing order, the offering documents
23 and transaction documents, and any legal opinions. Extensive review of the
24 securitization bond structure will also occur. Key legal elements of the transaction that
25 the rating agencies will look for include the following:³

26

27

28

29

30

31

1. The nonbypassable nature of the Securitization Charges (See Sections 8 and 12(b) of the Securitization Act).
2. Transfer of Securitization Property by CEI South to the SPE as an "absolute transfer" and "true sale," provided that the governing documentation expressly states that the transfer is an "absolute transfer" and a "true sale" (See Sections 14(a), 14(a)(1)(A), and 14(b) of the Securitization Act).

³ Where appropriate I have cited provisions to Ind. Code ch. 8-1-40.5, which codified Senate Enrolled Act 386 (hereinafter the "Securitization Act") which I believe address the rating agency issues.

- 1 3. A current property right (Securitization Property), which creates a separate and
2 current right to receive the revenues from the nonbypassable Securitization
3 Charges (See Sections 9, 11, 12(a), and 15(a) of the Securitization Act).
- 4 4. The assignment of the SPE's rights in the Securitization Property to the bond
5 trustee, for the benefit of the bondholders, in a perfected first priority security
6 interest (See Sections 15(a)-(d) of the Securitization Act).
- 7 5. The terms of a "true up" mechanism and frequency of adjustment (See Section
8 11(a) of the Securitization Act).
- 9 6. The sufficiency of expected collections to adhere to the scheduled amortization
10 schedule of the securitization bonds.
- 11 7. Transaction subaccounts.
- 12 8. The scheduled final payment dates compared to the legal final maturity dates
13 on the securitization bonds, and whether bond interest and principal is likely to
14 be paid off in the worst-case scenario by the legal final maturity dates.
- 15 9. The irrevocability of the financing order (See Section 10(f)(2) of the
16 Securitization Act).
- 17 10. The state non-impairment pledge and reaffirmation of the state's pledge by the
18 Commission (See Section 16(b) of the Securitization Act).
- 19 11. Any federal and state constitutional protections.
- 20 12. The presence of obligations to pay by all of the utility consumers (See Sections
21 8(2), 10(b)(2), and 12(b) of the Securitization Act).

22

23 Ultimately, the rating agency's analysis will determine the amount of credit
24 enhancement the structure will need. Apart from the capital contribution of 0.5 percent
25 of the initial securitization bond balance, which serves as a cash reserve, there is no
26 excess spread, subordination, overcollateralization, or letters of credit or surety bonds
27 typically required for a utility securitization. As stated, the primary form of credit
28 enhancement is the right to impose and collect nonbypassable Securitization Charges
29 from consumers in the amount necessary to repay principal, interest and ongoing costs
30 on the securitization bonds and the ability to adjust the amounts of the Securitization
31 Charges through the true-up adjustment. The performance of the securitization bonds
32 is primarily driven by the ability to accurately predict the future level of electricity

1 consumption, delinquencies, charge-offs and adjust for any variance by utilizing the
2 true-up adjustment.

3

4 **Q. Do you believe that the form of financing order proposed by CEI South**
5 **establishes the foundation necessary to secure the highest possible rating from**
6 **the rating agencies and the flexibility to structure the financing in a manner**
7 **consistent with investor preferences at the time of pricing?**

8 A. Yes, I believe that it does. Among other important features, the financing order:

- 9 - includes terms, such as a true-up mechanism, which ensure that the
10 Securitization Charges (under the Securitization Act) will produce revenues
11 adequate to meet scheduled debt service requirements and the ongoing costs
12 on a timely basis;
- 13 - provides provisions describing the nonbypassability of the Securitization
14 Charges;
- 15 - provides adequate provisions to mitigate any potential risk to the SPE of a CEI
16 South bankruptcy, which is accomplished via a legal "true sale" for bankruptcy
17 purposes to a bankruptcy-remote SPE;
- 18 - reaffirmation by the Commission of the state's non-impairment pledge;
- 19 - includes provisions that facilitate favorable "debt-for-tax" treatment for the
20 securitization; and
- 21 - includes provisions giving CEI South flexibility to include additional credit
22 enhancement and otherwise structure the tranching and other terms of the
23 bonds to obtain the optimal pricing through an Issuance Advice Letter process.

24

25 **Q. How will the rating agencies view securitization when assessing the utility's**
26 **debt credit rating?**

27 A. Each rating agency takes its own approach when assessing the qualitative and
28 quantitative impact of securitization on a company's credit.

29

30 Qualitatively, Moody's believes that the utility benefits from securitization given the
31 immediate source of cash and that consumers benefit from lower rates due to the
32 lower cost of capital associated with the bond coupon. The organization has indicated
33 that new frameworks surrounding securitizations will generally be tested over time as

1 regulatory agencies issue decisions. With this certainty may come benefits, such as
2 improved timeliness of recovery of operating and capital costs or improvements in
3 regulatory underpinnings, both of which can improve a utility's overall credit scores.
4 Quantitatively, Moody's focuses its analysis on credit metrics without securitization
5 debt for the utility since there are significant differences and benefits between
6 securitization debt issuances and the utility's traditional debt financing arrangements.
7 This approach acknowledges the credit benefits of securitization financing as
8 compared to traditional debt financing arrangements including the true sale of property
9 rights that insulate the securitization debt and related charges from the utility's pool of
10 assets and revenues and the nonbypassable charge and true-up mechanism.

11
12 Qualitatively, S&P views securitization as at least neutral, and generally positive for
13 credit quality. They appreciate the up-front cash proceeds that can be used to
14 potentially pay down debt that carries a higher coupon with interest savings passed
15 on to customers in the form of lower rates. Quantitatively, S&P deconsolidates
16 securitized debt and associated revenues and expenses when assessing a utility's
17 credit as long as the structure contains a number of protective features. These include
18 making the Securitization Charges irrevocable and nonbypassable; and that the
19 securitization structure is an absolute transfer and holds a first-priority interest in the
20 Securitization Charges, contains periodic "true-ups" to handle any over- or under-
21 collections, and a reserve account to handle any temporary shortfalls. According to
22 S&P, this off-credit treatment stems from the fact that all customers are responsible
23 for the principal and interest payments associated with the securitization, and the utility
24 essentially acts as a pass-through entity for servicing the debt.

25
26
27 **VII. DESCRIPTION OF THE MARKETING PROCESS FOR UTILITY SECURITIZATION**
28 **BONDS**

29
30 **Q. Please describe how utility securitizations are marketed and priced.**

31 A. Securitization bonds are expected to be an attractive investment to investors in
32 traditional asset-backed securities. Additionally, the securitization bonds will be
33 marketed to corporate debt investors that are buyers of utility issues and previous

1 utility securitizations who may see securitization bonds as an attractive investment.
2 The securitization bonds will be marketed to a broad investor base with the objective
3 of lowering the all-in cost as demand for securitization bonds increases. The marketing
4 process includes various phases, each uniquely tailored to each transaction. Below
5 are the general steps in a marketing process for utility securitization, but the actual
6 process could vary based on the then-current market environment at the time of
7 marketing.

8

9 1. **Pre-marketing.** This process is the marketing phase conducted before the
10 official transaction announcement, with the goal of soliciting broad investor
11 interest in the transaction. Typically, for SEC registered transactions, this
12 process begins after the final amendment to the registration statement is filed
13 with the SEC. Underwriters will work to bring the transaction to the attention of
14 investors and inform investors of the deal, its structure and terms, and its
15 strengths, and facilitate the answering of investor questions. This phase
16 generally includes an electronic notice to investors that the transaction is likely
17 to be announced shortly, a roadshow (usually in electronic form), educational
18 materials, and solicitations for one-on-one and group conference calls with
19 potential investors. The underwriters and issuer will also disseminate the
20 estimated pricing at which the securitization bonds will aim to price, or initial
21 pricing thoughts ("IPTs"), usually in the form of a credit spread over a
22 benchmark rate. In response, investors will provide indications of interest,
23 which is generally the dollar amount of securitization bonds they are requesting
24 at the specified IPTs.

25 2. **Announcement.** The next step is to officially announce the transaction to the
26 market, which is typically done after a few days of premarketing efforts.
27 Generally speaking, utility securitizations will price in the same week during
28 which they are announced, in order to reduce unforeseen event risk over the
29 weekend, which may affect deal execution. Following the official
30 announcement, the securitization bonds will be offered for sale to investors
31 through the team of underwriters selected for the transaction, and bond pricing
32 is further discussed. During this phase of the marketing process the
33 underwriters will keep a list of orders of indications often referred to as "the

1 book”, which is used to keep track of demand in each tranche of the
2 transaction. The aggregate demand received from the investors will be used to
3 shape the price guidance.

4 3. **Price Guidance.** Price guidance is discussed amongst the underwriters and
5 utility following the receipt of investor indications of interest and feedback. The
6 underwriters will send out a notice to investors with updated pricing thoughts,
7 which again are typically presented as a range of credit spreads stated against
8 the given benchmarks for the securitization bonds. Price guidance levels can
9 be the same, tighter (lower) or wider (higher) than the IPTs based on investor
10 demand in the transaction to that point. After releasing price guidance and
11 receiving sufficient orders from investors in each class, the underwriters will
12 announce a time to the market at which the book will close and no subsequent
13 orders will be accepted; this is commonly known as “going subject.” This step
14 can only occur when the book has at least an equal amount of orders on the
15 bonds as the principal amount of securitization bonds offered (generally
16 referred to as being “fully-subscribed”). The underwriters will exercise
17 professional judgment in making a recommendation to close the book, based
18 on all relevant factors, including market conditions, the speed at which orders
19 came in for investors, and the composition of investor types in the book.

20 4. **Price Testing.** After taking the book subject, underwriters will begin to refine
21 the pricing level. Based on the volume of investor interest and feedback,
22 underwriters may seek to adjust the spreads tighter, provided the adjustment
23 does not decrease the aggregate investor demand below the size of the
24 securitization bond. Testing of the pricing levels is generally done through an
25 electronic notice to investors of the tighter testing spread levels and gauging
26 investor demand at these levels. Price testing is done to ensure the maximum
27 distribution of the securitization bonds at the lowest prices possible, given
28 market conditions at the time of pricing. The underwriters will use professional
29 judgement with respect to the recommendation to the issuer for the amount of
30 tightening to arrive at finalized pricing spread levels.

31 5. **Launch.** Once the pricing levels have been determined for the transaction, it
32 will be launched at that specific spread level. The intention of this stage is to
33 officially declare to investors at which credit spread the securitization bonds

1 will be priced and issued. This will be the market clearing pricing level of the
2 credit spread, subject only to movements in the underlying benchmark rates.

3 6. **Allocation.** At this stage, the market clearing pricing level has been
4 determined by the marketing process, but the final book (how much each
5 investor will purchase) has yet to be determined. The underwriters will work to
6 recommend a specific amount of securitization bonds to be sold (or "allocated")
7 to each investor. Each allocation depends on a number of factors, including
8 but not limited to the size of the investor's order, when the investor placed its
9 order, the investor's experience in the sector, and the investor's flexibility
10 during the pricing process. Ultimately, each investor will purchase its final
11 allocations for the transaction at transaction settlement.

12 7. **Pricing.** The underwriters will price the transaction by spotting the underlying
13 benchmark rate and adding the market clearing credit spread to determine the
14 pricing securitization bond yield and coupon for the bonds.

15 8. **Settlement.** At the conclusion of the pricing process, CEI South along with its
16 underwriters and legal team, will work toward finalizing the transaction offering
17 and documents and close the transaction, with transaction settlement typically
18 occurring approximately five business days after pricing.

19
20 The above summary is general, and marketing efforts will be specifically crafted for
21 the transaction, based on the facts and circumstances of each deal, as well as the
22 investor feedback and orders on the actual day of pricing.

23
24
25 **VIII. UPFRONT COSTS (BOND ISSUANCE COSTS)**

26
27 **Q. What are the typical bond issuance costs associated with the issuance of utility
28 securitization bonds?**

29 A. Upfront costs associated with the issuance of utility securitization bonds are financed
30 from the proceeds of the securitization bonds. Upfront costs include underwriting fees
31 and expenses, any original issue discount, legal fees and expenses (including those
32 associated with application for the financing order), structuring advisory fees and
33 expenses, any interest rate lock or swap fees and costs (if any), Securities and

1 Exchange Commission registration fees, rating agency fees, accounting fees and
2 expenses, printing and EDGARizing costs, bond trustee fees and expenses, any
3 Commission fees and expenses, and other miscellaneous costs. Upfront costs also
4 include reimbursement to the utility for amounts advanced for payment of these costs.
5 Upfront costs may also include the costs of credit enhancement, including the costs of
6 funding any reserve or overcollateralization account, or of purchasing a letter of credit
7 or bond insurance policy. As stated above, under current market conditions, I do not
8 anticipate that CEI South will be required to fund an overcollateralization account or
9 obtain additional credit enhancement in connection with its proposed securitization
10 transaction. However, circumstances may change and CEI South should have the
11 flexibility to fund such credit enhancement costs if it might result in savings to
12 customers.
13

14 **Q. Has CEI South estimated its upfront costs in its testimony?**

15 A. Yes, upfront costs for the proposed securitization transaction are estimated in the
16 testimony of Witness Jerasa. Mr. Jerasa has estimated that total upfront costs for the
17 proposed securitization (assuming no additional credit enhancement) will be
18 approximately \$4.7 million, or 1.34 percent of the initial principal amount of the
19 securitization bonds.
20

21 **Q. Do you believe that these upfront cost estimates are reasonable and
22 appropriate, and consistent with prior utility securitizations?**

23 A. Yes, I believe that the upfront costs described in detail in Witness Jerasa's testimony
24 are reasonable and appropriate in light of the complexity of the proposed securitization
25 transaction and the long lead-time necessary to develop and bring this transaction to
26 a close. Similar to recent utility securitization transactions, the timeline for this
27 transaction (and associated upfront costs) accounts for the financing order application
28 process, the registration process with the SEC for a public offering, the bond
29 structuring and rating agency process, legal documentation and opinions and
30 transaction marketing and syndication. In arriving at my conclusions, I have reviewed
31 the underwriters' costs as well as total bond issuance costs in other recent
32 securitization transactions and compared it to the expected upfront costs that Mr.
33 Jerasa details in his testimony. Total upfront costs on these recent utility

1 securitizations have ranged from approximately 0.6 – 4.5 percent of the original
2 principal amount of the utility securitization bonds (see Table EKC-5).

TABLE EKC-5: RECENT UTILITY ABS ISSUANCE COSTS

Deal No.	State	Utility	Pricing Date	Size (\$mm)	Underwriting Fees (%)	Total Cost (\$mm)	Total Cost (% of Size)
1	CA	PG&E	May-22	\$3,600.000	0.40%	\$22.29	0.62%
2	TX	Entergy	Mar-22	\$290.850	0.40%	\$3.83	1.32%
3	MI	DTE	Mar-22	\$235.800	0.40%	\$5.70	2.42%
4	CA	SCE	Feb-22	\$533.265	0.40%	\$7.80	1.46%
5	NC	DEP	Nov-21	\$769.627	0.40%	\$7.19	0.93%
6	NC	DEC	Nov-21	\$237.210	0.40%	\$4.37	1.84%
7	CA	PG&E	Nov-21	\$860.399	0.40%	\$10.35	1.20%
8	WI	WEC	May-21	\$118.814	0.40%	\$5.31	4.47%
9	CA	SCE	Feb-21	\$337.783	0.40%	\$5.96	1.77%
10	TX	AEP Texas	Sep-19	\$235.000	0.40%	\$4.10	1.74%

3 **Q. Please provide a brief description of CEI South's contemplated securitization**
4 **bond financing plan.**

5 A. As discussed in greater detail in the testimony of Witness Jerasa, CEI South proposes
6 to finance up to \$350,125,000 of costs related to the retirement of electric utility assets
7 approved by the Commission through the issuance of securitization bonds backed by
8 Securitization Charges.

9

10

11 **IX. CONCLUSION**

12

13 **Q. Please summarize your testimony.**

14 A. I believe that utility securitizations will yield the lowest cost of funds to the utility, in
15 view of the expected AAA ratings, which will in turn produce a lower net present value
16 of total Securitization Charges than traditional rate making. I also believe that the form
17 of the financing order proposed by CEI South establishes the legal foundation
18 necessary to secure the highest possible rating from the rating agencies and to

1 structure the financing in a manner consistent with investor preferences at the time of
2 pricing. For these reasons, the proposed financing order should be adopted by the
3 Commission.

4

5 I also believe that CEI South's proposed bond issuance costs for the proposed
6 securitization bond issuance are reasonable, in light of historical precedent.

7

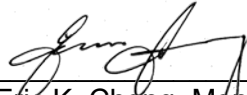
8 **Q. Does this complete your direct testimony?**

9 A. Yes, it does.

VERIFICATION

I affirm under penalties for perjury that the foregoing representations are true to the best of my knowledge, information, and belief.

SOUTHERN INDIANA GAS AND ELECTRIC
COMPANY D/B/A CENTERPOINT ENERGY
INDIANA SOUTH



Eric K. Chang, Managing Director, Securitized
Products Origination at Barclays Capital Inc.

May 9, 2022

Date