Executive Summary

Critical Electric Power Infrastructure Recovery and Reconstruction:

New Policy Initiatives in Four Gulf Coast States After 2005’s Catastrophic Hurricanes

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ENERGY AND MEASURES FOR RISK MITIGATION AND TRANSFER
Introduction

During the Atlantic hurricane seasons of 2004 and 2005, significant parts of the states of Alabama, Florida, Louisiana, Mississippi, and Texas were hard hit by a series of named hurricanes and tropical storms. These storms caused catastrophic damages to critical electric power infrastructure. During the 2004 hurricane season, severe destruction was confined mostly to the State of Florida, where three named hurricanes and one tropical storm crisscrossed much of the same electric utility service territories multiple times in a period of less than two months. Florida’s five large investor-owned utilities (IOUs) each had tens or hundreds of millions of dollars in storm reserve funds going into the 2004 hurricane season; at the end of it, most of these storm reserve funds were tens to hundreds of millions of dollars in deficit. The notorious hurricane season of 2005 provided no respite for Floridians and the State’s electric IOUs, and catastrophic Hurricanes Katrina, Rita, and Wilma spread destruction on an unprecedented scale beyond Florida to its neighboring Gulf Coast states of Alabama, Louisiana, Mississippi, and Texas. Until Katrina, no Gulf Coast state had experienced the frequency and destructiveness of storms as had Florida. Other public service commissions had yet to address storm cost recovery on such a massive scale and, as a result, storm reserve accounts in those four states had fewer funds than those of Florida’s IOUs.

As a practical matter, commercial insurance for most transmission and distribution (T&D) assets ceased to exist or the premiums became cost-prohibitive after Hurricane Andrew in 1992. For example, prior to 1993, Florida Power & Light (FPL) paid a $3.5 million annual premium for T&D insurance that provided up to $350 million of coverage per occurrence in each year the policy was in force. After Hurricane Andrew, FPL was offered a $100 million aggregate loss limit T&D policy – not per occurrence – for a minimum annual premium of $23 million. Given existing storm actuarials, passing post-Hurricane Andrew insurance costs onto customers as a cost of doing business probably would have raised questions as to whether such expensive and limited insurance met the tests of being “reasonable, prudently-incurred, used, and useful”. The inability of Gulf states’ policymakers to form a regional insurance pool, as sought by Florida over a decade ago, coupled with the inability to purchase adequate and reasonably priced T&D insurance led the Florida Public Service Commission (PSC) to approve the establishment of individual utility self-insurance funds in 1993. The purpose of these “storm reserves” was to pay for uninsured losses with funds allocated to a reserve account on an accrual basis under a formula in an IOU’s base rates for each customer class. Importantly, the IOU’s customers, not its shareholders, pay the PSC’s determination of “reasonable and prudently incurred costs” for restoring electricity and reconstructing destroyed infrastructure after a storm.

This pay-as-you-go accrual method of financing storm recovery worked reasonably well for about a decade. The occurrence of major hurricanes was infrequent enough that these storm reserves proved adequate without the need for large and periodic increases in rates or surcharges to replenish expenses from the fund. Whenever such surcharges are added to customers’ monthly bills, concern over the potential for
“rate shock” exists, especially regarding low and/or moderate income residential consumers. Both consumers and utility regulators are reluctant to support “pre-payments” to a reserve account to reimburse the IOU for some unquantifiable future storm-related cost even though defensible arguments can and have been made that there are customer and utility benefits to ensuring adequately funded reserves. However, in final determinations, public service commissions operating, under enormous and conflicting interests and pressures, have more often than not prescribed under-funded storm reserve accounts – a solution that has come unglued.

A New Approach to Catastrophic Electric Power Infrastructure Cost Recovery: Securitization

This report examines a new, optional technique authorized by all four Gulf state legislatures that is seeing increasing acceptance and use by public service commissions. “Securitization” in the context of cost recovery for IOUs refers to the creation and use of a new type of bond issue that falls within the general category of Asset-Backed Securities and its subset, Utility Tariff Bonds (UTBs). UTBs were first employed by Washington State regulators in 1995 to recover demand-side management costs. To achieve the important twin objectives of “least cost” financing and federal tax-free status, storm cost recovery securitization invariably starts with a specific grant of new statutory authority to state commissions from the state legislature. In the four states assessed for this report, underlying statutes in Florida, Louisiana, and Texas are generally similar. The fundamental difference between these three approaches and that of the fourth state assessed, Mississippi, is that a Mississippi State agency will issue storm bonds whereas in the other three states private sector entities will do so. Since Florida was the first of the four states to pass storm securitization legislation (June 2005) and its Commission was the first in the Nation to issue a final financing order (July 2006), this paper generally refers to Florida’s law and regulatory processes.

In issuing the Nation’s first storm cost recovery securitization, or financing, order for FPL, the Florida PSC noted that the new method “will be unlike any debt or equity securities previously approved by this Commission . . . [which] represents an extraordinary relinquishment of future regulatory authority and a shifting of all economic burdens associated with storm-recovery bonds from FPL to its customers.”

The June 2005 Florida statute has six essential elements which are congruent with a September 2005 Internal Revenue Service Revenue Procedure. The statute creates an intangible property right to a specific stream of customer revenues that clearly is owned by the utility which will be sold to a “bankruptcy remote” third party often called a Special Purpose Entity (SPE). Although technically owned by the utility, at least one of the SPE’s managers must be independent of the utility, and the Commission retains the right to block the sale of bonds up until the day they are to be issued. The “extraordinary relinquishment” stated by the Florida PSC refers to other statutory elements. The FPL financing order is irrevocable; once bonds are issued the Commission cannot reopen the matter. True-ups/true-downs conducted by the Commission are automatic and based solely on a mathematical calculation using actual financial returns. Storm recovery bond charges to
FPL’s customers are non-bypassable, meaning that no matter what happens to FPL in the future, including but not limited to acquisition, merger, or even bankruptcy, any successor entity is legally empowered and required to collect storm bond revenues from all customers in FPL’s service territory as it exists at the time of the order. Further, the Order is backed by a regulatory pledge that Florida “has pledged and agrees with bondholders, the owners of the bondable storm recovery property, and other financing parties that the State will not impair the value of bondable storm recovery property” as required by law. It is important to note, however, that the state assurance is a full faith and credit pledge in Mississippi.

After receiving a request from FPL for securitized recovery of its 2005 storm costs, the Florida PSC engaged in a process of hearings, evidence gathering, and fact-finding almost identical to traditional proceedings. The key difference was, and is, the unprecedented involvement of a financial advisor to assist the Commission and staff with navigating the complexities of securitization. A financial advisor, Saber Partners LLC of New York City, was retained by the PSC; Saber also represents the interests of ratepayers by achieving “lowest cost” for the bond issuance. FPL petitioned the PSC for $1.05 billion in recoverable 2005 storm costs and a $650 million storm reserve fund. The PSC, however, disallowed nearly $300 million of FPL’s claims, and issued a financing order for $708 million. The Commission also reduced the size of FPL’s reserves to $200 million. As of September 2006, a Bond Review Team has been established with at least one Commissioner and several staff members actively involved; it has met with institutional investors and underwriters on Wall Street and, subject to final go-ahead from the PSC, is poised to issue storm bonds through the SPE. FPL will sell its rights to its property – storm bond fees it collects from customers – to the SPE. To pay for this property, the SPE sells bonds to large institutional investors. FPL, however, will act as administrator and servicer for the bonds for fees set by the PSC in its order. The utility immediately transfers the revenues it collects from its customers to the SPE. On a quarterly basis, the SPE makes principal and interest payments to bondholders, whereas with typical corporate bonds principal is paid at maturity.

Storm securitization laws in Louisiana and Texas create multi-phase processes whereby a certain number of days must pass before commencing a PSC determination on whether to allow securitization for costs deemed to be recoverable in the first phase. Accordingly, if storm bonds are issued by utilities in these states, it is anticipated the bonds will not appear on the market until late in the first quarter to middle of the second quarter of 2007. Mississippi’s PSC is awaiting final award and allocation of Community Development Block Grants (CDBG) funds to its four investor-owned electric and gas utilities before issuing instructions to the State Bond Commission on the amount of storm bonds to be issued.

**Federal Funding for Critical Electric Power Infrastructure Restoration After a Catastrophe**

The US Congress passed two FY 2006 emergency supplemental appropriations bills that provided $11.5 billion (P.L. 109-148) and $5.2 billion (P.L. 109-234) to the Community Development Block Grant (CDBG) program administered by the US Department of Housing and Urban Development (HUD). Both

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statutes specifically mention that an undefined portion of the total $16.7 billion appropriated can be used for “restoration of infrastructure”. A specific definition of “infrastructure” is found at 24 CFR 570, § 570.201 subparagraph (l): “Privately owned utilities. – CDBG funds may be used to acquire, construct, reconstruct, rehabilitate or install the distribution lines and facilities of privately owned utilities. . . .” FY 2006 supplemental CDBG funds go only to areas in the Gulf Coast states that were covered by presidentially-declared emergencies, with a preference to “most impacted” areas. Fifty-five percent of the grants are allocated to “unmet housing needs” subject to basic tests for eligibility, most notably the program’s Low- and Moderate-Income (LMI) means-tests. Congress provided HUD with authority to waive most CDBG requirements, including LMI, subject to notification requirements. CIPP researchers have found only two instances prior to the 2005 hurricanes where Congress made supplemental appropriations for CDBGs that included possible allocations to IOUs, both of which subsequently became mired in controversy.

For an electric utility actually to receive CDBG funds to pay for its storm-related infrastructure reconstruction, HUD must first make a state-by-state allocation of appropriated funds. Next, the governors of the affected states submit “action plans” to the Secretary of HUD. In the somewhat opaque back-and-forth negotiations between HUD and a governor’s designee(s), a state’s action plan is approved. Subject to the issuance and notification of any waivers that may be required to conform normal program requirements to the approved action plan, HUD releases CDBG funds which designated state agencies then distribute accordingly. As of September 2006, Mississippi’s HUD-approved Ratepayer Mitigation Plan provides the clearest example of how one state plans to provide $360 million in federal grants to its two electric IOUs – Mississippi Power and Entergy Mississippi – and its two gas utilities to reduce storm-induced rate increases. At a September 19, 2006 news conference, Governor Kathleen Blanco of Louisiana provided a “ballpark estimate” that her administration would provide $200 million in CDBG funds to IOUs. Yet, as September 2006 draws to a close, HUD has not provided congressional notifications or waivers and no CDBG funds have been released to utilities.

Considerations Regarding the Use of Securitization and/or Federal CDBG Funds to Pay for Catastrophic Losses of Electric Power Infrastructure

All four Gulf Coast states examined for this report have made securitization one of the options that can be used to pay for unprecedented infrastructure costs that have overwhelmed traditional mechanisms and reserve funds. At least two of these states also intend to use what appears to be a very small percentage of their overall allocations of CDBG funds to pay some of the IOUs’ infrastructure recovery costs. Proponents of each of these policy instruments have made a number of arguments in their favor, several of which are summarized below. Less visible in the current environment are concerns about widespread use of securitization by state commissions and electric utilities, and precedents that may be established by a
provision of CDBG funds to IOUs that may impose daunting demands on federal taxpayers in the aftermath of future catastrophes; several such concerns also are represented below.

The most frequently mentioned benefits of securitization are that utilities receive a more immediate infusion of cash to pay for storm restoration costs and that the “rate shock” to customers is minimized when compared to “traditional” methods. Securitization insulates the utility from the issuance of debt for which its customers are the debtors; this preserves the utility’s credit position. AAA-rated bonds provide investors with security and ratepayers with “least cost” financing, thus lowering the amount each customer class will pay. Given the data and information currently available, these benefits seem to be true. On the other hand, independent ratings agencies and other experts caution that securitization can be overdone – it is not a panacea for each and every utility cost recovery docket. Ellen Lapson of Fitch Ratings, for example, suggests that any given securitized bond issue should be less than 20 percent of the total utility bill and preferably much less. She and other experts advise against using securitization to pay for fuel costs, retiring profit-earning assets, or to finance a “permanent layer of utility capital structure”.

Speaking at the National Association of Regulatory Utility Commissioners’ (NARUC) 2006 Winter Committee Meetings, former Michigan Commissioner and NARUC President David Svanda offered an old story with a contemporary securitization analogy illustrating how the use of UTBs can be helpful or harmful depending on the circumstances. Mr. Svanda begins by recounting a young reporter’s attempt during the days of Prohibition to pin down a sage politician by asking his views on consumption of alcohol, to which the voice of political experience, if not expedience, replied that he could be all for it or dead set against it; whether alcohol is the “spirit that liberates our souls” or “that vile substance” all depends on perception, implementation, and outcome. To paraphrase Mr. Svanda’s contemporary analogy as to whether securitization can be seen as a “good” or “bad” policy tool – or somewhere in between – the three tests of perception, implementation, and outcome can be applied. Securitization probably will withstand the test of time when it reduces regulatory uncertainty, when it encourages badly-needed investments in electric power infrastructure to improve reliability or to harden systems, when it is used to pay for high-cost environmental remediation projects or reconstruction caused by catastrophic events, and when it provides market-based “least cost” debt financing that protects investors yet truly offers the best result for consumers and policy.

Over the longer term, securitization may fail if it is repeatedly used for the kinds of costs incurred today that reasonably could and should be paid for today, such as fuel costs; if it mortgages ratepayers for generations; is used to pay for profit-making assets, thus removing them from the earnings ledger; or if the cumulative total costs of securitizations exceed what independent ratings firms will tolerate to provide the AAA rating. CIPP researchers often posed hypothetical “what ifs” to commission staff, such as “the financing order pays for the costs of year 2005 hurricanes over 12 years. What if securitization continues to be used for
the next year’s storms, the next, and the next?” The likelihood that the Gulf Coast states will escape one if not several costly disasters over the proposed life of today’s storm recovery bonds seems remote.

Use of CDBGs for IOUs’ storm recovery costs raises some of the same kind of paradoxes, for which there is no “right” answer at this time. For example, when a regional catastrophe overwhelms the abilities of state emergency officials and IOUs to quickly and comprehensibly restore electricity without further sending ratepayers into a tailspin and thus retarding economic recovery and growth, then a limited use of CDBG money may be a “good thing”. If, however, commissions, utilities, and customers develop a dependency on federal grants to avoid making tough but necessary decisions about continued development in harm’s way, and to avoid planning and paying for future needs of a hardened, more resilient electric power infrastructure, then the use of CDBG funds may come to be viewed as something “bad”. The determination of “good” or “bad” all depends on how federal money actually is delivered, used, and is accounted for. Implementation, accountability, and outcomes will matter, and not just presently in the Gulf Coast states.

When, in FY 1998, Congress made the first emergency supplemental appropriation that permitted impacted states to tap CDBG funds for IOU recovery costs, a caution was raised by House and Senate managers that warrants repeating today:

*The Conference have serious misgivings about providing CDBG funds for disaster mitigation [which differs from restoration], particularly given the waiver authority and the possibility that the majority of funds will be spent to cover the repair costs of investor-owned utility companies.*

In 2002, Congress again appropriated CDBG funds to pay for Con Edison’s recovery costs as the result of the 9/11 attacks. However, the Public Utility Law Project of New York recently stated that “[t]he question of who will pay for the utility recovery costs of the 2001 World Trade Center attack remains unresolved in 2006.” Robert J. Michaels, a professor of economics at California State University-Fullerton points to a knowledge void in which CIPP concurs: “[t]here is a near total lack of research on how regulators should monitor utilities’ disaster recoveries and the proper scope of this [CDBG] activity.”

CIPP research to-date suggests that a legal twilight zone exists between Stafford Act emergency response authorities and long-term restoration after the lights are on again, which at this time seem to be addressed ad hoc. From the limited record, it is not clear that CDBGs, funded in the emotional and political contexts of national disasters and emergency supplementals, are the appropriate instrument to fill current statutory and administrative voids. This is an area that is ripe for future research and analysis.
Reference Document

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ENERGY AND MEASURES FOR RISK MITIGATION AND TRANSFER
Foreword

This report to the Office of Electricity Delivery & Energy Reliability (OE) under a grant from the National Energy Technology Laboratory (DE-FG26-04NT42250) is a distillation of nearly five months of research into how four Gulf Coast states and the Federal government have responded to the challenge of recovering catastrophic losses to critical electric power infrastructure inflicted during the 2005 hurricane season. Deliverables included are an Executive Summary, a Reference Document, and appendices, which include document and research maps.

Atypical serial mega storms led to a regional catastrophe in the Gulf states in 2005 that had been predicted but for which no state or the Federal government was truly prepared. The Gulf states lacked adequate policies, plans, and provisions for the restoration and recovery of unprecedented destruction of critical electric power infrastructure. Due to the far-reaching policy, regulatory, and financial implications of the future implementation of new cost recovery methods, the Critical Infrastructure Protection Program (CIPP) at George Mason School of Law has reviewed recent changes to the cost recovery landscape in four select Gulf Coast states.

A multidisciplinary five-person team was assembled at CIPP in early May 2006 to investigate these issues, studying cases in the states of Florida, Louisiana, Mississippi, and Texas. The CIPP research team examined thousands of pages of state public utility commission dockets, transcripts, orders, and state statutes underpinning regulatory activities. Additionally, researchers reviewed hundreds of additional documents, including but not limited to reports issued by state executive agencies, legislatures, and commissions; the Congressional Research Service (CRS); the Government Accountability Office (GAO); the National Association of Regulatory Utility Commissioners (NARUC); the electric utilities’ trade associations, specialized industry trade press, and other media sources; and the few academic writings that exist on this topic. As valuable as this literature review has been to our understanding of the issues, the most enlightening contributions to CIPP’s research has been the dozens of formal and informal interviews conducted with state commission staffs, former commissioners, officials at the US Department of Housing and Urban Development (HUD), utility officials, and other experts.

The CIPP research team was provided extraordinary access and developed relationships that resulted in an ongoing flow of information and insights.

This paper provides reporting and analysis of how state legislatures, state public service (utility) commissions, consumers, and investor-owned utilities in these states are responding to the recent and unprecedented destruction of critical electric power infrastructure.
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This report would not have been possible without the help of many organizations and individuals who gave their time willingly to further our research. They not only provided us with invaluable information, but also insights into processes and thinking that would be missed in only examining the dockets and the literature. Special thanks to everyone who assisted in our research endeavors, including:

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Introduction

In the Atlantic hurricane seasons of 2004 and 2005, significant parts of the states of Alabama, Florida, Louisiana, Mississippi, and Texas were hard hit by a series of named hurricanes and tropical storms. These storms caused catastrophic damages, including severe destruction of critical electric power infrastructure. During the 2004 hurricane season, catastrophic destruction was confined mostly to the State of Florida, where three named hurricanes and one tropical storm crisscrossed much of the same electric utility service territories multiple times in a span of less than two months. Florida’s large investor-owned utilities (IOUs) each had tens of millions of dollars in storm reserve funds going into the 2004 hurricane season; at the end of it, most of these storm reserve funds were tens to hundreds of millions of dollars in negative balance. The notorious hurricane season of 2005 provided no respite for Floridians and the State’s critical energy infrastructure, and Hurricanes Katrina, Rita, and Wilma spread destruction on an unprecedented scale beyond Florida to its neighboring Gulf states of Alabama, Louisiana, Mississippi, and Texas. In recent times, no Gulf Coast state had experienced the frequency and destructiveness of storms as had Florida. As a result, storm reserve accounts in those jurisdictions were typically not as well-funded as compared to Florida’s IOUs, and public service commissions had yet to address storm cost recovery on such a massive and wide scale.

As a practical matter, commercial insurance for most transmission and distribution (T&D) assets ceased to exist, or the premiums became cost-prohibitive after Hurricane Andrew in 1992. For example, prior to 1993, Florida Power & Light (FPL) paid a $3.5 million annual premium for T&D insurance that provided up to $350 million of coverage per occurrence in each year the policy was in force. After Hurricane Andrew, FPL was offered a $100 million aggregate loss limit T&D policy – not per occurrence – for a minimum annual premium of $23 million. 1 In an attempt to develop a regional insurance pool to reduce

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1 Florida, “Petition to Implement a self-insurance mechanism for storm damage to transmission and distribution system and to resume and increase annual contribution to storm and property insurance reserve fund by Florida Power and Light Company,” Public Service Commission Orders, 93-0918 (June 17, 1993), 1.

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Premiums post-Hurricane Andrew, Florida initiated discussions with its neighboring states to create a regional self-insurance pool to cover otherwise uninsurable losses to critical infrastructure from hurricanes, tropical storms, and other large-scale natural disasters. Seemingly, other states and IOUs in the region believed that such a plan transferred an inordinate amount of risk away from Florida and onto other states and IOUs in the region. As a result, the regional self-insurance pool never materialized.

In response to the inability to form a regional pool coupled with the inability to purchase adequate and reasonably priced T&D insurance, the Florida Public Service Commission (PSC) approved the establishment of individual utility self-insurance funds in 1993. The purpose of these “storm reserves” was to pay for uninsured losses with funds allocated to a reserve account on an accrual basis under a formula in an IOU’s base rates for each customer class. Periodic adjustments were made to the accounts by the Florida PSC based on the total amount accrued in the storm reserve and the amount of cost recovery expensed by the IOU following a particular storm. Importantly, the IOU’s customers, not its shareholders, pay the “reasonable and prudently incurred costs” of restoring electricity after a storm. The states of Louisiana, Mississippi, and Texas also utilized storm reserve accounts, but, as a general rule, these states did not allow as large of an accrual as the State of Florida.

This pay-as-you-go accrual method of financing storm recovery, which this report refers to as the “traditional” method, worked reasonably well for approximately one decade. During this time, the occurrence of major hurricanes was infrequent enough that storm reserves proved adequate without the need for large and periodic increases in rates or surcharges to replenish expenses from the account. Whenever such surcharges are added to customers’ monthly bills, concern over the potential for “rate shock” exists, especially regarding low and/or moderate income residential consumers. Both consumers and utility regulators are typically are reluctant to support “pre-payments” to a reserve account to reimburse the IOU for some unquantifiable future storm-related cost. On the other hand, IOUs and consumers benefit from adequately-funded storm reserve accounts for a number of reasons. First, accounts funded to a level to cover

2 Source: CIPP researchers’ conversations with staff of the Florida Public Service Commission (June-September 2006).
3 Florida, 93-0918 (June 17, 1993), 1.
storms producing above average recovery costs minimize the IOU’s borrowing costs associated with carrying such cost-recovery expenses from non-storm reserve fund accounts. Second, accounts adequate to cover recovery costs without resulting in a negative account balance improve market and investor confidence in the IOU post-recovery. Third, adequately funded accounts reduce rate volatility post-storm, which benefits customers by reducing rate shock. In the final determination, public service commissions have more often than not allowed under-funded storm reserve accounts – a solution that has not worked over the past two years.

To highlight this concern, a recent Edison Electric Institute (EEI) publication highlighted the difficult financial and regulatory concerns over paying for storm recovery costs in Florida and the Gulf Coast states following the 2004 and 2005 storm seasons. The report provides important insight into the use of reserve funds or ex post approval of accounting treatments as a self-insurance mechanism. According to the report, few investor-owned utilities maintain reserve funds, and, in certain cases, the funds provided no cash to pay for recovery. Regarding the significant losses in Florida during 2004, the reserve funds in place were inadequate to cover the entire operation and maintenance (O&M) recovery costs.

Driven by unique needs in the wake of the 2004 hurricane season, Florida generally leads Louisiana, Mississippi, and Texas in storm cost recovery processes described in this report. At the start of the 2005 hurricane season – i.e., June 1, 2005 – the Florida Legislature enacted legislation that allowed utilities the option of petitioning the Florida PSC for a financing order which includes the option of utilizing securitization for allowable storm damages in addition to the traditional form of cost recovery utilizing storm reserve accounts. In response to the mega storms of 2005 – Hurricanes Katrina, Rita, and Wilma – Louisiana, Mississippi, and Texas each passed securitization laws in 2006. With the exception of Mississippi, the basics of the

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securitization laws are the same or similar for the other three states assessed in this report – Florida, Louisiana, and Texas.

Subject to final Florida PSC approval on bond structure and pricing, the first storm recovery bonds for the State’s largest IOU, FPL, are expected to be issued in late 2006. The Mississippi PSC will, on or before October 27, 2006, issue two final financing orders for Mississippi Power (MPCO, a Southern Company) and Entergy Mississippi (EMSI). If Community Development Block Grant (CDBG) money is not “in hand” by the 27th, the financing orders will contain contingency language to guide the State Bond Commission.

Due to the far-reaching policy, regulatory, and financial implications of the future implementation of such new cost recovery methods, the Critical Infrastructure Protection Program (CIPP) at George Mason University School of Law has reviewed recent changes to the cost recovery landscape in the states of Florida, Louisiana, Mississippi, and Texas. This report provides reporting and analysis of how state legislatures, state service (utility) commissions, consumers, and IOUs in these states are responding to the recent and unprecedented destruction of critical electric power infrastructure.

**Traditional Storm Cost Recovery Approaches**

**Florida**

**Traditional Accounting Methodology**

Florida statutes permit cost recovery through an accumulated provision account. These accounts cover losses through accident, fire, flood, nuclear accidents, storms, or similar events which are not covered by insurance.\(^6\) Accounts can be separately established for injury, property damage, and miscellaneous expenses caused by a disaster.\(^7\) IOUs must seek approval to establish the rate at which IOU funds accrue into the account and must also justify their withdrawals with supporting records of the expenses.\(^8\) The accrual method used post-Hurricane Andrew was sufficient until 2004.


\(^7\) Ibid.

\(^8\) Ibid.
The Florida PSC authorized utilities to operate these accounts in 1993, after Hurricane Andrew devastated South Florida in 1992 and changed the insurance industry. IOUs were no longer able to obtain sufficient insurance coverage at a reasonable price. As CIPP research conducted in 2005 found,

[A]dequate commercial insurance capacity and products are not currently available in the electric sector. … [C]oncerns over adverse selection and the inability to adequately spread the risk of threats to the electric system were perceived as major obstacles to the development of new insurance capacity or products.  

Thus, the Florida PSC allowed IOUs to create storm reserve accounts as a self insurance mechanism. These accounts, which can be either funded or unfunded, allow IOUs to accrue funds to pay for storm damages on a monthly basis. Traditionally, IOUs funded their accounts through their base rates. However, the resultant recovery costs associated with storm damage during 2004 and 2005 were greater than the reserve fund accounts all four of the main IOUs in Florida. The storm reserve deficits following damage restoration ranged from $28 million for Tampa Electric Company’s (TECO) up to $533 million for Florida Power & Light (FPL).

The Florida Administrative Code broadly sets forth how the reserve account, formally called Account No. 228.1 Accumulated Provision for Property Insurance, will function. An accrual rate for the account is specified at rate proceedings, although IOUs can also petition for a change in the level of accrual outside of a rate proceeding. This regulation requires that “[i]f a utility elects to use any of the above listed accumulated provision accounts, each and every loss or cost which is covered by the account shall be charged to that account and shall not be charged directly to expenses.” Charges shall be made to accumulated provision accounts regardless of the balance in those accounts.”

2004 Storm Season Orders

Florida IOUs, with the exception of Florida Public Utilities Company, petitioned the Florida PSC for permission to recover their prudently incurred storm recovery costs from ratepayers following the 2004 and 2005 storm seasons. The petitions following the 2004 storm season were “traditional” requests, where the approved amount is recovered through a surcharge on customers’ bills. With the exception of TECO’s hearing, the Florida PSC approved surcharges which allowed IOUs to recover storm costs and replenish their

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9 Florida, 93-0918 (June 17, 1993), 1.
12 Ibid.
13 Ibid.
14 Florida, Administrative Code Annotated, 6.0143(1)(a)-(b).
storm reserve accounts. Only one IOU entered the 2005 storm season with a positive reserve balance. Under Florida’s statutes and administrative code, IOUs must book storm damage recovery costs to its damage reserve account. However, commissions may allow IOUs to expense these costs for tax purposes. Once an amount is approved for recovery and amortization, it is considered a regulatory asset. The amount is placed in a sub-account of the company’s reserve account to allow for tracking and review of the amounts included and their subsequent amortization.

**Tampa Electric Company**

Three storms struck TECO’s service area in 2004: Hurricanes Charley, Frances, and Jeanne. As a result of these storms, the company experienced the “worst outage situation in the Company’s history”. Like all other IOUs in the State, TECO maintained a reserve fund to cover costs associated with storm damage. Prior to the 2004 storm season, this account had accrued $42.33 million. However, TECO’s recovery costs associated with the 2004 storms totaled approximately $73.4 million. Charging the entire amount to the storm reserve would have created a negative balance of approximately $30 million. In response, the Florida PSC approved a settlement and stipulation agreement between TECO, the Florida Office of Public Counsel (OPC), and other interveners that allowed TECO to capitalize $38.88 million of its storm costs. The Florida PSC rationalized capitalizing this amount in the following way:

The $38.877 million to be capitalized includes approximately $14.1 million that could be considered “normal” costs if the activities had not been undertaken for restoration purposes related to the hurricanes. The difference of approximately $24.8 million is the “excess capital cost” which is a direct result of the rapid restoration of service. We would normally take exception with the capitalization of this “excess capital cost.” However, in this case, we find that capitalizing this amount does not harm the customer. The result of leaving this amount in the storm reserve account or capitalizing it as electric plant in service has no current effect on rate base. The effect of not capitalizing the amount would result in a negative instead of a positive storm reserve going into the 2005 hurricane season. We therefore do not take exception to the capitalization of this amount in this case.

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17 See 05-0748 (July 14, 2005), 23.
18 Florida, “Joint petition of Office of Public Counsel, Florida Industrial Power Users Group, and Tampa Electric Company for approval of stipulation and settlement as full and complete resolution of any and all matters and issues which might be addressed in connection with matters regarding effects of Hurricanes Charley, Frances, and Jeanne on Tampa Electric Company’s Accumulated Provision for Property Insurance, Account No. 228.1” Public Service Commission Orders, 05-0675 (June 20, 2005), 3.
19 Florida, 05-0675 (June 20, 2005), 2.
20 Ibid., 6. [Emphasis added].
As a result, TECO’s reserve account reflected a positive balance of $7.86 million.²¹ Per the stipulation agreement, TECO agreed to continue to accrue $4 million annually to its storm reserve and not to request a surcharge to cover costs of the 2004 storm season. In deciding to approve the settlement agreement, the Florida PSC noted that the agreement balanced the interests of ratepayers and the utility and that it would not result in a rate increase.²²

Gulf Power

In 2004, Hurricane Ivan disrupted electricity service to 90 percent of Gulf Power’s (Gulf) customers,²³ resulting in approximately $141.5 million in recovery costs.²⁴ After insurance reimbursements, Gulf was left with $124.3 million in recovery costs that it sought to recover through a surcharge; charging this amount to the storm reserve would have created a negative balance of approximately $96.5 million. Through the stipulation and settlement agreement, this amount was significantly reduced to $51.39 million.²⁵

The Florida PSC’s order reduced Gulf’s charges to the reserve account through several techniques. First, because Gulf exceeded its authorized return on equity for 2004, Gulf made an additional accrual of $14 million to the account that resulted in a rate of return to the middle of the authorized range.²⁶ Additionally, Gulf was allowed to “exclude from recovery through the proposed surcharge that portion of the capital expenditures and cost of removal related to recovery from Hurricane Ivan equal to the normal amount that would be charged to capital accounts under normal conditions.”²⁷ The Florida PSC authorized a two-year surcharge to recover the remaining $51.39 million, resulting in a $2.78 charge per month for a typical residential customer or a total of $66.72 over the two-year amortization period.²⁸

Florida Power & Light

Hurricanes Charley, Frances, and Jeanne also impacted FPL’s service area in 2004. FPL originally claimed $890 million to its storm reserve.²⁹ However, the Florida PSC reduced this amount to $794.31 million; the disallowances included insurance reimbursements, capital costs, and other costs that could not be appropriately charged to the reserve fund.³⁰ Given that FPL had a storm reserve of approximately $354

²¹ Ibid., 2.
²² Ibid., 9-10.
²⁴ Ibid.
²⁵ Ibid.
²⁶ Ibid., 7.
²⁷ Ibid., 5.
²⁸ Ibid., 8
³⁰ Ibid., 22.
million at the time of the hearing, booking the adjusted amount to the storm reserve would have resulted in a
deficit of $365 million.\textsuperscript{31} Therefore, a total of $441.99 million was ordered to be recovered from customers
over a three-year period resulting in a $1.65 charge per month for a typical residential customer or $59.40
over the three-year amortization.\textsuperscript{32} As a result, the storm reserve had a negative balance going into the 2005
season, and would remain so through February 2008 assuming it incurred no other storm expenses during the
three-year surcharge period.

**Progress Energy**

Prior to 2004, Progress Energy (Progress) collected “$6 million annually in base rates for
transmission and distribution property damage” in a reserve storm damage account.\textsuperscript{33} When the first 2004
hurricane struck, Progress’ reserve fund was valued at $46.9 million.\textsuperscript{34} Progress incurred two million
customer outages and $366 million in storm related costs\textsuperscript{35} as a result of Hurricanes Charley, Frances, Jeanne,
and Ivan.\textsuperscript{36}

Progress’ initial request was for a storm recovery clause that would have allowed the company to
recover $251.9 million over two years. Rather than permit a storm recovery clause, the Florida PSC ordered a
surcharge to be collected over two years to recover $231.84 million in storm-related costs.\textsuperscript{37} As was the case
with other IOUs, the Florida PSC excluded amounts that could be appropriately capitalized and disallowed
other charges to the reserve account, such as certain classes of employee overtime.

**Louisiana**

The Louisiana Public Service Commission’s Constitutionally-Derived Powers

The Louisiana PSC’s general authorities originate not in statute as is the case in the other states, but
in the Louisiana Constitution, which explicitly creates an elected public service commission with the authority
to regulate all public utilities and common carriers and to manage their rates.\textsuperscript{38} The applicable statutes further
elaborate and create an elected body with the power to exercise all necessary regulations over anything
connected to public utilities, except for the parish of Orleans.\textsuperscript{39} New Orleans is served by a specific power

\textsuperscript{31} Ibid., 2.
\textsuperscript{32} Ibid., 39.
\textsuperscript{33} Florida, “Petition for approval of storm cost recovery clause for recovery of extraordinary expenditures related to Hurricanes
Charley, Frances, Jeanne, and Ivan, by Progress Energy Florida, Inc.,” *Public Service Commission Order*, 05-0748 (July 14, 2005), 20.
\textsuperscript{34} Ibid.
\textsuperscript{35} Ibid., 19.
\textsuperscript{36} Ibid., 1.
\textsuperscript{37} Ibid., 4.
company, Entergy New Orleans (ENOI), and a separate New Orleans Public Service Commission, which
jurisdictionally is under the control of the New Orleans City Council. Furthermore, the PSC’s powers do not
apply to electric cooperatives unless they have explicitly submitted to the Commission’s authority via a
general vote of their membership.\(^{40}\) Any decision of the Commission is subject to judicial review in an
ordinary court within the district where the appellant resides, with the standard of review being the same as
ordinary civil cases.\(^ {41}\)

The PSC has a special economics and rate analysis division dedicated to evaluating matters relating to
service and rates.\(^ {42}\) The Commission can require public utilities to extend their services and facilities if the
revenues from the extension will pay for the new infrastructure.\(^ {43}\) To ensure that these rules are followed, the
Commission can investigate the reasonableness of the utilities’ rates and the authenticity of their declared
operating expenses.\(^ {44}\) These investigations can lead to significant changes in a utility’s proposed rate
schedule. For example, in order U-17282-L, issued February 10, 1993, the Louisiana PSC found that Gulf
States Utilities Company improperly classified some of its costs, which led the Commission to deny their
recovery through rates until the costs were properly classified.\(^ {45}\) The Commission required that hourly
customers with high loads pay lower incremental charges and that the utility offer more “no interruption”
service plans to its industrial customers.\(^ {46}\) In a compromise with Gulf States, the Commission required in the
same order that industrial customers pay more than they did in the utility’s original rate plan, but not as much
as the Commission staff recommended out of concern for the utility’s ability to market to its industrial
customers.\(^ {47}\)

To pay for its operating costs, the Louisiana PSC has created special funds operated with fees
collected from the regulated utilities, such as an inspection and supervision fund or an economics and rate
analysis fund.\(^ {48}\) The Commission also requires the utilities under examination to pay for the reasonable
certified costs of the attorneys and consultants retained by the Commission during an investigation.\(^ {49}\) To ease
this burden on the utilities, the Commission does allow utilities to recapture any fees or payments collected by
a regulatory body as part of the utilities’ average rates.\(^ {50}\) In addition, the Commission retains the exclusive
right to govern the issuance of securities or obligations by the utilities.\(^ {51}\) Such securities can only be created if

\(^ {40}\) Louisiana, \textit{Louisiana Statutes Annotated}, 45:1163.
\(^ {41}\) Louisiana, \textit{Louisiana Statutes Annotated}, 45:1192.
\(^ {42}\) Louisiana, \textit{Louisiana Statutes Annotated}, 45:1163.3.
\(^ {43}\) Louisiana, \textit{Louisiana Statutes Annotated}, 45:122.
\(^ {44}\) Louisiana, \textit{Louisiana Statutes Annotated}, 45:1176.
\(^ {45}\) Louisiana, “Proposed Revision of its Electric Rates & Charges Within the State of Louisiana,” \textit{Public Service Commission Orders}, U-
17282-L (February 10, 1993), 1.
\(^ {46}\) Ibid., 1-2.
\(^ {47}\) Ibid., 2.
\(^ {49}\) Louisiana, \textit{Louisiana Statutes Annotated}, 45:1181.
\(^ {50}\) Louisiana, \textit{Louisiana Statutes Annotated}, 33:4510.
\(^ {51}\) Louisiana, \textit{Louisiana Statutes Annotated}, 45:1168.
they serve a necessary purpose for the utility and they must strictly follow the Commission’s orders at all times.\textsuperscript{52} The Commission reaffirmed this power in its order “Commission Approval of Security Issues and Assumptions of Liability”, issued June 5, 1996, where it reiterated that no regulated utility could assume any liability or obligation without the Commission’s express approval.\textsuperscript{53}

The City of New Orleans: Outside the Normal Jurisdiction of the Public Service Commission

New Orleans’ public utilities are governed separately from the rest of the State’s regulators. Since 1921, the City has operated under a separate Home Rule Charter.\textsuperscript{54} The New Orleans City Council has complete power of supervision and regulation over utilities within the boundaries of the Louisiana State Constitution.\textsuperscript{55} The council may set rates, allocate awards or funds distributed for the benefit of a utility under the council’s supervision, assess regulatory fees, audit corporate records, and investigate utility operations.\textsuperscript{56} To help carry out this authority, the Council has established a Department of Utilities (DOU).\textsuperscript{57} This body recommends rate changes, analyzes the terms of the franchises granted by the City Council, recommends legal enforcement proceedings when necessary, and makes public reports.\textsuperscript{58} The Department is also authorized to investigate any utility facility or record.\textsuperscript{59}

New Orleans’ electric and natural gas utilities (two entities) are wholly-owned subsidiaries of Entergy DE. Entergy New Orleans (ENOI) is the electric power utility; it is the only IOU in the Gulf states to have declared bankruptcy, doing so just a few weeks after Hurricane Katrina made landfall. The fact that New Orleans utilities are not under the general jurisdiction of the Louisiana PSC has created tensions between the PSC and the City Council-DOU. CIPP Researchers note that these historic tensions appear to have increased post-Katrina. ENOI has aggressively pursued immediate cost recovery before City Council, which as of September 2006 it has not received. The Louisiana PSC has taken the unusual step of retaining special outside counsel to advice the Commission and staff on ENOI’s bankruptcy activities and with the City Council. ENOI is seeking to recover lost revenues as part of its storm restoration and bankruptcy strategies. Normally, state commissions do not allow lost revenues and both the City Council-DOU and the Louisiana PSC are no exceptions. ENOI also has aggressively pursued CDBGs, and has factored the possible receipt of federal money in both its bankruptcy reorganization plan pending in federal court and efforts to sell the company to the city – something which is commonly referred to in ENOI’s statements and the trade press as

\textsuperscript{52} Louisiana, \textit{Louisiana Statutes Annotated}, 45:1171 & 45:1172.  
\textsuperscript{55} New Orleans, \textit{Home Rule Charter}, 3-130.  
\textsuperscript{56} Ibid.  
\textsuperscript{57} New Orleans, \textit{Home Rule Charter}, 4-102 & 4-108.  
\textsuperscript{58} New Orleans, \textit{Home Rule Charter}, 4-1601.  
\textsuperscript{59} New Orleans, \textit{Home Rule Charter}, 4-1602.
“municipalization”. Ironically, the City actively tried to purchase ENOI from the parent holding company in the late 1980s and early 1990s, but Entergy DE refused the City’s offers. Now, it is the City Council that is balking at a purchase. Based upon information available as of late September 2006, ENOI’s three initiatives – storm cost recovery, bankruptcy reorganization, and municipalization – are unlikely to play out until January 2007 at the earliest.

Other State Agencies

Out of the other important regulatory agencies in Louisiana that manage electric utilities, two bear mentioning. One is the Louisiana Emergency Preparedness Association (LEPA) and another is the Southern States Energy Board (SSEB). For further information on these bodies, please consult the electronic appendix.

Mississippi

Storm cost recovery prior to 2005 was achieved through the reserve fund/surcharge accounting methodology generally used by IOUs after affordable T&D insurance became unavailable. 60 The most notable order of the Mississippi PSC exemplifying the traditional regulatory approach to cost recovery is associated with the State’s February 1994 severe ice storm. The ice storm decimated northern Mississippi, leaving 85,000 of Mississippi Power & Light’s (MP&L) 61 customers without service. 62 As a result, MP&L added $33.6 million in new plant and equipment and incurred an operation and maintenance (O&M) expense of $10.7 million during recovery. After accounting for the tax savings associated with the incremental O&M expenses, the total incremental costs associated with the storm totaled $40.25 million. 63

On April 15, 1994, MP&L filed a notice of intent to change its rates after the severe ice storm of 1994. MP&L proposed a rate rider which would reflect its incurred storm costs through May 31, 1994 and would last until March 15, 1995. 64 At that point, rate adjustments reflecting the total ice storm recover costs would be put into place, though they would be restricted to a five-year period and an annual adjustment of no more than two percent of MP&L’s annual revenues or $14.5 million, whichever was less. 65 On August 4,
1994, MP&L and the Mississippi Public Utilities Staff (MPUS)\textsuperscript{66} agreed to a joint stipulation allowing MP&L to recover $10.04 million in storm recovery costs incurred through April 30, 1994.\textsuperscript{67} It also set the five-year annual revenue requirement for the recovery of all storm costs to be $7.99 million, set to go into effect for bills rendered after September 29, 1994.\textsuperscript{68} The rate rider was allocated by customer class and increased electrical bills between $0.00071 and $0.00147 per kWh.\textsuperscript{69} On July 19, 1995, MP&L and MPUS agreed to a second joint stipulation. This stipulation set the ice storm recovery costs at $14.2 million and set a five-year annual rate requirement at $2.54 million to be allocated among customer classes.\textsuperscript{70} This would result in additional charges of between $0.00020 and $0.00045 per kWh, depending on the customer class. On September 13, 1995, the Mississippi PSC issued a second order approving the second joint stipulation.\textsuperscript{71}

\textbf{Texas}

As a retail-competition, or deregulated, state, Texas statutes, regulations, and commission activities address the issue of utility cost recovery from a slightly different perspective than non-retail choice states such as Florida, Louisiana, and Mississippi. Self-insurance is still an option for any potential liability or catastrophic property loss which can not be reasonably anticipated and included in the utility's base rates.\textsuperscript{72} The Texas Public Utility Commission (PUC) must approve any self-insurance plan, and will do so only if it is determined to be in the public interest, is a lower cost alternative to commercial insurance, and the ratepayers will receive the benefit of the savings.\textsuperscript{73} The Texas PUC judges the proposal on the basis of information available at the time and has the power to add a shortage or subtract a surplus in the insurance fund by adjusting base rates.\textsuperscript{74} Of note, this option is not available to nuclear facilities.\textsuperscript{75} An exemplary Texas PUC docket on self-insurance is docket number 22350, issued October 3, 2001. In this docket, TXU Electric Company wanted to recover $13.5 million in rates to replenish its self-insurance reserve, which was operating at a deficit of $27.2 million.\textsuperscript{76} Only $6.8 million was to be dedicated to expected losses, while $4.9 million would go towards amortizing the under-recovered deficit and only $1.8 million would go to building up the

\textsuperscript{66} MPUS operates independently of the Commission. It serves two primary purposes: (1) provide the Commission with expert research and advice, and (2) represent consumer interests before the Commission.

\textsuperscript{67} Mississippi, 94-UN-228 (August 4, 1994), 3.

\textsuperscript{68} Ibid., 5-6.

\textsuperscript{69} Ibid., 11.

\textsuperscript{70} Mississippi, 94-UN-228 (July 19, 1995), 7-8.

\textsuperscript{71} Mississippi, 94-UN-228 (September 13, 1995).

\textsuperscript{72} Texas, Vernon's Code of Texas Annotated, Utilities: 36.064.

\textsuperscript{73} Ibid.

\textsuperscript{74} Ibid.

\textsuperscript{75} Ibid.

\textsuperscript{76} Texas, Application of TXU Electric Company for Approval of Unbundled Cost of Service Rate Pursuant to PURA § 39.201 & Public Utility Commission Substantive Rule § 25.344,” Public Utility Commission Dockets, 22350 (October 3, 2001), 76.
self-insurance fund to the target of $7.3 million within four years. The Texas PUC found that TXU was improperly counting 2002 self-insurance accruals in its 1999 calculations and disallowed the $6.8 million.

*Entergy Gulf States*

On November 16, 2005, Entergy Gulf States (EGSI) filed its first set of responses to the Texas PUC’s set of questions regarding Hurricane Rita costs. EGSI estimated its Hurricane Rita costs between $230 million to $305 million for its facilities in Texas. Estimated insurance proceeds were between $50 million to $100 million. EGSI predicted that a final estimate of its costs would be available by March 31, 2006.

Entergy noted that it had maintained its high credit ratings despite the storm, but its outlook had been downgraded. This was partially due to the fact that, while EGSI was allowed a $1.7 million annual accrual to its catastrophe reserve, previous storms had left the fund with a $12.8 million negative balance. Furthermore, EGSI explained that it was statutorily barred from commencing a base rate proceeding until June 30, 2007, and those rates would be effective no earlier than June 30, 2008. EGSI argued that this left it with the serious risk of harm to its financial stability and credit rating, especially considering “it is fair to say that no one contemplated the occurrence of an event of the magnitude of Hurricane Rita during the development and passage of this legislation.”

EGSI stated that a special rate rider was one possible solution, as other companies in other states such as Florida had been granted the right to collect their storm costs through special rate riders. EGSI also recommended that the Commission lobby for securitization legislation because, “if EGSI could securitize its storm damage costs in the manner currently allowed for stranded costs and regulatory assets, those financing cost benefits, and lower costs, could be passed on to ratepayers.”

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77 Ibid.
78 Ibid., 80.
80 Ibid., 2.
81 Ibid., 4.
82 Ibid., 3.
83 Ibid., 5.
84 Ibid., 6.
85 Ibid., [The legislation referenced is HB 1567, which froze new rate cases until June 30, 2008. The same restriction is repeated in HB 163, the State’s securitization bill (Texas State Legislature, Called Session 2006, HB 163).]
86 Ibid., 7.
87 Ibid., 8.
New Storm Cost Recovery Approaches

Due to the extreme magnitude and geographic span of the damage to electric infrastructure in Florida during the 2004 storm cycle, the recurrence of another such destructive storm season in 2005 should have had an extremely low probability. However, the 2005 hurricane season proved disastrous not only in Florida, but especially in Louisiana and Mississippi where IOU storm reserve funds have historically been much lower than in Florida. As a result, the devastation of Hurricanes Katrina, Rita, and Wilma overwhelmed these reserves and forced the Gulf Coast states to reexamine their cost-recovery approaches.

Florida

Prior to the 2005 storm season, the Florida legislature began examining alternative methods to fund storm recovery costs, and in 2005 passed a securitization law as an alternative methodology to finance storm recovery costs. Briefly, securitization allows special bonds to be issued that both quickly infuse utilities with cash and simultaneously reduce overall costs to customers. A full explanation of this cost recovery tool is provided in the section on securitization. In 2006, the Florida PSC issued a landmark order that incorporated securitization as a major cost recovery tool. This order represents a dramatic change in the traditional approach to cost recovery in Florida.

Florida Power & Light Orders: General Findings

The Florida PSC issued two orders during 2005 and 2006 related to IOUs’ petitions for financing bonds. In 2005, Florida Power & Light (FPL) entered into a stipulation and settlement agreement with various other parties in Order Florida PSC-05-0902-S-EI, issued September 14, 2005. Inter alia, as part of the settlement agreement, FPL agreed to stop accruals to its storm reserve on January 1, 2006. The Florida PSC ordered that a target level for FPL’s reserve would be set in a separate proceeding, using either a separate surcharge or Florida’s securitization law. The Commission incorporated the previous year’s surcharge into its 2006 securitization order. The 2004 storm season surcharge remains in effect as of September 2006, but will go away once bonds are issued.

FPL’s initial petition, filed January 13, 2006, requested storm recovery bonds in the amount of up to $1.05 billion pursuant to Florida’s securitization law.88 This requested amount would allow FPL to (1) recover the unrecovered balance of its 2004 storm recovery costs; (2) recover prudently incurred 2005 storm recovery costs; (3) replenish its storm recovery reserve; and (4) recover issuance costs associated with the

storm-recovery bonds. Based on this filing, the request would have allowed FPL to remove the $1.65 surcharge for the 2004 storms from residential customers’ bills, thereby reducing the total monthly bill to a currently estimated $1.10 per month. However, the average industrial consumer would have a monthly increase of $359.38, or less than 0.1 percent of the consumer’s total bill.

Although FPL initially requested a financing bond totaling more than $1 billion, the Florida PSC found that storm bonds in the amount of up to $708 million would fully reimburse FPL for its “reasonable and prudently incurred storm-recovery costs associated with the destructive back-to-back 2004 and 2005 storm seasons” and “cover the other costs associated with the bond.” Importantly, the Florida PSC only allowed FPL to fund its storm reserve to $200 million, in contrast with FPL’s initial request to fund the reserve to $650 million. Furthermore, the Florida PSC found that:

“Customers represented in this proceeding have made clear that they would rather pay to fund the reserve to a lower level now and risk future rate volatility than pay to fund the reserve to a higher level before future storm restoration costs have been incurred.”

During the hearing, the Florida Industrial Power Users Group argued that the reserve should be replenished to a lower level:

While it is not entirely clear that FPL needs a positive storm reserve at all, if the Commission decides to grant FPL such a reserve then, as discussed in the testimony of [Office of Public Utility Counsel of Texas]/AARP witness Stephen A. Stewart, an appropriate level for FPL’s storm reserve is $150 million. In fact, a storm reserve level of only $60 million would have been sufficient to handle 13 of the last 16 storm seasons. By comparison, FPL requests a storm reserve level almost 11 times that amount, yet its request would add only a small additional measure of security: FPL’s proposed $650 million storm reserve would have been sufficient to handle 14 of the last 16 storm seasons. Given that a $60 million reserve would have been sufficient to cover most but not all of the last 16 storm seasons, it seems conservative that a reserve 2 ½ times that amount would be sufficient to satisfy the needs of FPL and its customers.

Consistent with standard regulatory accounting practices, the Florida PSC disallowed or reduced many items that FPL sought to recover. The Florida PSC used an incremental cost approach to determine which costs may be included in a customer surcharge by removing items that are recoverable through base rates from the surcharge, thereby preventing a “double recovery.” For example, the Florida PSC found that

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89 Ibid., 3.
90 Source: CIPP researchers’ conversation with Florida Public Service Commission staff (September 12, 2006). [Actual storm bond surcharge amounts will not be known until bonds are sold.]
92 Ibid., 25.
93 Ibid.
94 Florida, 06-0464 (May 2, 2006), 8-9.
95 Florida, 06-0464 (May 30, 2006), 17.
$15.36 million of ordinary payroll expenses included in FPL’s petition were included in base rates and thus were not allowed in storm recovery costs.96

The Florida PSC also disallowed items that were not part of FPL’s base rates, but were inappropriate for other reasons. For example, in its findings of fact, the Florida PSC noted that FPL included tree-trimming expenses in its storm-recovery costs. The Florida PSC found that, “FPL’s actual tree trimming expenditures were $1.1 million less than the amount budgeted for 2005.” Consistent with the incremental cost approach, FPL’s 2005 storm-recovery costs were adjusted by removing $1.1 million related to tree trimming expenses.97

The Florida PSC reduced the amount that FPL sought to recover to compensate for recovery costs that FPL could have avoided. The Florida PSC ruled that many of the pole failures that occurred as a result of the 2005 storms were due to inadequate vegetation management and pole maintenance. When determining whether storm-recovery costs are reasonable and prudent, the Florida PSC must make an appropriate determination “with reference to the general public interest in, and the scope of effort required to provide, the safe and expeditious restoration of electric service.”98 To that end, the Florida PSC found that some of FPL’s poles failed due to deterioration, the replacement costs of which were $2.2 million. The Florida PSC removed $550 million from the rate base and required that FPL reduce the charges to its reserve by the remaining $1.65 million.99 Similarly, the Florida PSC found that $3.4 million in storm recovery costs were due to a reduction by FPL in its level of vegetation management around its poles and poles owned by other entities. The Florida PSC held that “FPL’s responsibility to provide reliable service extends to the consequences associated with managing vegetation around third-party poles supporting FPL facilities as much as it applies to its own poles.” Of the $3.4 million, the Florida PSC ruled that $850,000 should be removed from the rate base and that the remaining amount $2.55 million should be subtracted from FPL’s charges to its reserve fund.100

Securitization-Specific Issues

Section 366.8260 of the Florida statute is broad in that it does not specify how the storm bonds must be structured. However, the actual order is quite specific. The Florida PSC describes the storm-recovery bonds as “unlike any debt or equity securities previously approved by the FL PSC” and involves “an extraordinary relinquishment of future regulatory authority and a shifting of all economic burdens on

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96 Ibid., 18.
97 Ibid.
98 Ibid., 22.
99 Ibid., 23.
100 Ibid.
connection with storm-recovery bonds from FPL to its customers.” 101 As a result, the Florida PSC established clear standards for how the bonds would be structured and issued to safeguard customers. These standards were established pursuant to Section 366.8260(2)(b)(2)(j), which states that the Florida PSC may “include any other conditions that the Florida PSC considers appropriate and that are not otherwise inconsistent with this section.”

The Florida PSC was clear that FPL’s bonds should have an AAA rating from at least two nationally recognized rating agencies. 102 To this end, the bond is to be administered by a SPE rather than FPL itself. The Special Purpose Entity (SPE) will be a Delaware Limited Liability Company (LLC). The SPE is required to, “as long as storm recovery bonds remain outstanding … have at least one independent manager, that is, with no organizational affiliation with FPL or its affiliates.” 103 The SPE is not allowed to institute bankruptcy or any similar proceedings without the consent of this manager. The Florida PSC indicated that it “must forego future regulatory oversight in order to create a financing instrument of superior quality and a completely separate credit from the sponsoring utility.” 104

In the financing order, the Florida PSC ruled that a representative of the Florida PSC must be a member of the Bond Review Team leading up to bond issuance. 105 Florida’s Bond Review Team, which first met in July 2006, is comprised of representatives from FPL, the Office of Public Counsel (OPC), the Office of the Attorney General, Florida Retail Federation, Florida Industrial Power Users Group, AARP, Federal Agencies, and other interested parties. The Bond Review Team is charged with establishing “the structuring, marketing and pricing of storm-recovery bonds.” 106 Even after the structure and pricing of the bond is determined, the Florida PSC retains discretion to stop the transaction if “the transaction fails to comply with applicable law or this Financing Order, or if FPL, the book running underwriters(s), or this FL PSC’s financial advisor is unable or unwilling to deliver the required certifications in a form acceptable to the FL PSC.” 107 The Florida PSC issued a clarifying order on July 21, stating that the Florida PSC would stop the transaction if it does not meet with these requirements. 108 Once bond issuance occurs, the Florida PSC’s oversight will be limited to approving mathematical errors in a periodic true-up mechanism.

As of September 2006, the Florida PSC and FPL are moving forward with the bond issuance process. According to the Florida PSC staff, the bonds are anticipated to be issued in November 2006, and will be high-quality/low-interest bonds issued in four tranches with staggered maturities including two, five,
seven, and 10 years. The predicted interest rate is 5.06 percent, but the actual rate will depend on market conditions and the structure of the bond at the time of issuance. Based on the final parameters associated with the issuance, the monthly bond charges could be in the range of $1.05 to $1.10 for a typical residential customer, which is lower than the previously estimated monthly charge. \(^{109}\) To further expound on this information, an appendix to this report analyses net present value.

**Gulf Power**

Gulf Power experienced three major storms during the 2004 and 2005 storm seasons. In 2004, Hurricane Ivan impacted Gulf's service area and, in 2005, Gulf suffered damage resulting from Hurricanes Dennis and Katrina. Following Hurricane Ivan, Gulf's recovery costs totaled approximately $137.7 million. \(^{110}\) This amount was initially scheduled through recovery through a surcharge instituted in 2005 and ending in 2007. \(^{111}\) Hurricanes Katrina and Dennis resulted in a total of $63.6 million, with insurance covering approximately $900,000 of this amount. Gulf “further reduced this amount by voluntary exclusions of $9.4 million to a net jurisdictional balance of $53.3 million of unrecovered storm restoration costs.” \(^{112}\) In addition, Gulf requested to recover $70 million to place in its storm reserve account.

On June 20, 2006, the Florida PSC ruled on Gulf Power's petition for a financing bond. Gulf's original petition sought a bonding that would cover the balance of the utility's Hurricane Ivan storm-recovery costs, the storm recovery-costs associated with Hurricanes Dennis and Katrina, and the addition of $70 million to Gulf's storm reserve account. However, Gulf instead sought a traditional surcharge that would recover the Dennis and Katrina costs and replenish the company's storm reserve. These charges would be in addition to the Hurricane Ivan surcharge that remained in effect at the time of Gulf's request.

The June 20, 2006 order also approved a stipulation agreement between Gulf, the OPC, and other interested parties. As a result of the stipulation agreement, the Florida PSC ordered Gulf to “extend the current storm cost recovery surcharge for and additional 27 months from April 2007 through June 2009. For a typical residential customer using 1,000 kWh, the current charge is $2.57.” \(^{113}\) In addition, Gulf will, *inter alia*, continue to accrue money to its storm reserve, but only through base rates, and not as an additional surcharge. \(^{114}\) It is believed that the traditional reserve approach was preferred by Gulf due to the size of the

\(^{109}\) Source: CIPP researchers’ conversation with Florida Public Service Commission staff (September 12, 2006).
\(^{111}\) Ibid.
\(^{112}\) Ibid., 132.
\(^{113}\) Florida, 06-0601 (July 10, 2006), 2.
\(^{114}\) Ibid., 3.
bond issuance and/or concern over securing an acceptable bond rating based on the utility’s damage and storm recovery fund replenishment estimates.”

**Louisiana**

**Statutory Cost Recovery Innovations**

Recent changes in the Louisiana statutes reflect the high priority that the Louisiana legislature places on quickly recovering from natural disasters. As indicated in 45:859, which was passed as SB 8 during the legislature’s First Extraordinary Session and approved on November 18, 2005:

*The swift restoration of electric and gas utilities following natural disasters such as tropical storms, hurricanes, and floods can minimize the devastating effects of such disasters. Therefore, the restoration and rebuilding of electric and gas utilities as a result of a natural disaster is hereby recognized to be a valid public purpose in the best interests of the citizens and businesses of the state.*

On May 22, 2006, the Louisiana Electric Utility Storm Recovery Securitization Act was signed into law, authorizing electric utilities to securitize their storm recovery costs. Based on this act, an IOU may petition the Louisiana PSC for a financing order to recover its storm recovery costs. The Louisiana PSC will then determine what costs may be securitized, and the funds granted by the bond issuance may be used for purposes expressly approved in the financing order. The Louisiana PSC must judge the bond issuance on the basis of whether the proposed structure of the financing order would result in lower overall costs or would mitigate the impact of the storm recovery costs on ratepayers. Once bonds are issued, the storm recovery charge is included in the base rate on customers’ bills instead of being separated out as a line item. This means that consumers will not know how much of their bills are going to finance the storm recovery bonds. In contrast to Florida, where securitization of recovery costs represents a new authority of the Florida PSC, the Louisiana securitization bill merely confirms that such an option was already available pursuant to the Louisiana PSC’s enabling authority under the State Constitution.

The Louisiana PSC financing order must specify which costs are recoverable, including increases in storm reserves minus any insurance or federal aid the utility collects. The order must also specify the storm

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115 Source: CIPP researchers’ interview with staff of the Florida Public Service Commission (Early August 2006).
117 Ibid., 8.
118 Ibid., 9.
119 Ibid., 9.
120 Ibid., 15.

This document represents a preliminary assessment based upon publicly-available sources of data and information for ongoing storm cost recovery processes in selected Gulf Coast states. The views expressed herein are those of the authors and may not represent those of the institution.
customer of ELAI would see an increase of about $2.37 a month, or a 1.9 percent increase.\textsuperscript{137} Both IOUs submitted an amended application in the fourth quarter of 2006, following tabulation of their final storm recovery costs.\textsuperscript{138}

To justify their requests, both IOUs pointed to significant under-recoveries of their fuel and purchased power costs which led to lower deferred fuel balances.\textsuperscript{139} They also cited their lowered credit ratings, with EGSI’s Standard & Poor’s (S&P) rating moving from “Stable” to “Outlook Negative” and ELAI’s S&P rating moving from “Stable” to “Watch Negative”.\textsuperscript{140} Moreover, they specifically quoted S&P as stating that the listing, “reflects the potential that Entergy’s underlying business may have been irreparably harmed by the devastation wrought by Hurricane Katrina” and that resolution depends on many things, including “the level of responsiveness from state authorities, including regulators, and the timeline for Entergy to recover its storm costs.”\textsuperscript{141} The companies argued that recovery of storm costs was in the public interest as it would assure the financial community of Entergy’s continued stability and ability to purchase goods.\textsuperscript{142} The two IOUs promised to more fully consider securitization as a cost recovery option during the second phase of the Commission’s three-phase process\textsuperscript{143} and pursue securitization if the Louisiana PSC found it to be an appropriate vehicle.\textsuperscript{144} They also cited their respective formula rate plans’ \textit{force majeure} clause, which allows the companies to recover these extraordinary costs outside of normal rate processes.\textsuperscript{145}

On February 22, 2006, an outside consultant hired by the Louisiana PSC staff, William Barta of Henderson Ridge Consulting, testified on his recommendations regarding EGSI and ELAI’s application for joint interim storm cost relief.\textsuperscript{146} Mr. Barta noted that the Louisiana PSC had previously commented favorably on Entergy’s emergency operations plan and had specifically indicated its support for the recovery efforts from Hurricanes Katrina and Rita in a special resolution issued on October 19, 2005.\textsuperscript{147} However, while the consultant stated that EGSI and ELAI’s storm recovery costs appeared to be in accord with the emergency operations plan and general storm recovery accounting guidelines, he recommended that the costs

\textsuperscript{137} Ibid., 2-3.  
\textsuperscript{138} Ibid., 3.  
\textsuperscript{139} Ibid., 12.  
\textsuperscript{140} Ibid., 13.  
\textsuperscript{141} Ibid.  
\textsuperscript{142} Ibid., 15.  
\textsuperscript{143} The Commission handles applications for securitization in three phases. Phase one is the IOU’s application for relief of its storm recovery costs, which are accounted for in the application. Phase two is the review of the IOU’s expenses, usually by an outside consultant, to reduce the recoverable amount as much as possible by deducting tax benefits and imprudent IOU expenditures. Phase three is the issuance of a financing order with the allowed amount, the creation and monitoring of the SPE, and the issuance of the bonds. This breakdown is based on the transcript of a Louisiana PSC meeting (July 12, 2006).  
\textsuperscript{144} Louisiana, U-29203 (December 2, 2005), 15.  
\textsuperscript{145} Ibid., 18-19.  
\textsuperscript{146} Louisiana, U-29203 (February 6, 2006), 3.  
\textsuperscript{147} Ibid., 4.  

\textit{This document represents a preliminary assessment based upon publicly-available sources of data and information for ongoing storm cost recovery processes in selected Gulf Coast states. The views expressed herein are those of the authors and may not represent those of the institution.}
be more closely analyzed in phase two of the recovery process.\textsuperscript{148} Mr. Barta also stated that a high percentage of the companies’ costs were reasonable and prudent.\textsuperscript{149}

Mr. Barta recommended reducing the IOUs’ capital costs by 10 percent because, “it is presumed that a certain amount of the capital costs included as part of the Companies’ storm restoration request represents ‘normal’ construction project activity.”\textsuperscript{150} This represented an $8.1 million reduction in EGSI’s request and a $23.5 million reduction in ELAI’s request.\textsuperscript{151} He also recommended removing the IOUs’ business continuity costs, or those costs incurred to keep normal operations going during the storm, because those costs were not extraordinary.\textsuperscript{152} This would reduce EGSI’s request by another $3.3 million and ELAI’s request by another $5.6 million.\textsuperscript{153} Mr. Barta further recommended reducing the total request by the amount of Entergy’s insurance coverage, or $400 million.\textsuperscript{154} Cumulatively, these changes reduced EGSI’s storm recovery revenue requirement from $124.4 million to $68 million and ELAI’s revenue requirement from $307.6 million to $158 million over a 10-year period.\textsuperscript{155} Correspondingly, EGSI’s monthly revenue requirement was lowered from $1.5 million to $835,000 and ELAI’s monthly requirement was lowered from $3.9 million to $2 million.\textsuperscript{156} Mr. Barta also explained that he considered securitization a preferable option to normal cost recovery.\textsuperscript{157} With securitization, EGSI’s monthly revenue requirement would be further reduced from $835,000 to $698,000,\textsuperscript{158} while ELAI’s monthly requirement would be reduced from $2 million to $1.7 million.\textsuperscript{159}

On March 3, 2006, the Louisiana PSC approved an interim order regarding EGSI and ELAI’s request for interim relief, or phase one of their request for complete storm recovery relief.\textsuperscript{160} The Louisiana PSC allowed EGSI to recover no more than $6 million and ELAI to recover no more than $14 million cumulatively between March and September 2006.\textsuperscript{161} These recovery amounts were classified as an extraordinary cost charge which would end when the full amount was collected.\textsuperscript{162} After the Louisiana PSC is finished investigating the IOUs’ permanent costs and subtracting any insurance proceeds, federal assistance, or tax relief, it will develop a revenue requirement for permanent storm recovery.\textsuperscript{163} The Louisiana PSC also

\begin{footnotesize}
\begin{itemize}
  \item 148 Ibid., 9 & 13.
  \item 149 Ibid., 14.
  \item 150 Ibid., 15.
  \item 151 Ibid.
  \item 152 Ibid., 15-16.
  \item 153 Ibid., 16.
  \item 154 Ibid.
  \item 155 Ibid., 18.
  \item 156 Ibid.
  \item 157 Ibid., 19.
  \item 158 Ibid.
  \item 159 Ibid.
  \item 160 Louisiana, U-29203 (March 3, 2006), 1 & 4.
  \item 161 Ibid., 5.
  \item 162 Ibid., 6.
  \item 163 Ibid.
\end{itemize}
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directed EGSI and ELAI to develop a securitization proposal no more than three months following approval of the final revenue requirement. Until that plan is approved, the IOUs would continue to collect their interim recovery amounts.

Pursuant to a May Request for Proposals (RFP), the Louisiana PSC met on July 12, 2006 to discuss the hiring of an outside consultant to audit Entergy’s expenses and determine if they were reasonable and prudently incurred. The consultant would also be responsible for overseeing the bond issuance and ensuring that it would provide the most possible benefit to ratepayers. On a three-to-two vote, the Commission decided to re-cast the original RFP so that it captured the intricacies of securitization that were brought out in direct testimony. On September 12, 2006, the Commission voted to retain outside counsel, selected accounting experts and chose a financial advisor to assist with securitization. The Louisiana PSC’s decision to hire experts was crucial because the financing order is irrevocable once issued, and Entergy’s customers will be responsible for the debt.

On July 31, 2006, EGSI and ELAI filed an estimate of their hurricane recovery costs for phase two of their cost recovery application. Through May 31, 2006, EGSI declared $200.3 million and ELAI declared $466.8 million. The companies provided calculations for three different cost recovery allocation methods: (1) by customer class in proportion to the class’s contribution to revenues; (2) by usage; and (3) by customer class but excluding transmission voltage. For a typical EGSI customer, this would result in a surcharge of $2.21 a month (2.2% increase), $1.51 a month (1.5 percent increase), and $2.63 a month (2.6 percent increase) utilizing each method, respectively. For a comparable ELAI residential customer, this would result in a surcharge of $2.78 a month (3% increase), $2.10 a month (2.2 percent increase), and $3.15 a month (3.4 percent increase) utilizing each method, respectively. The companies noted that they anticipated filing a second, amended application with a sample financing order as part of a petition for securitization under Louisiana’s new securitization statute.

164 Ibid.
165 Ibid., 7.
166 Louisiana, U-29203 (July 12, 2006), 19.
167 Ibid., 20.
169 Louisiana, U-29203 (July 31, 2006), 1.
170 Ibid.
171 Ibid., 3.
172 Ibid.
173 Ibid.
174 Ibid., 3-4.
Mississippi

Securitization Efforts

On March 6, 2006, Mississippi enacted the Hurricane Katrina Electric Utility Customer Relief and Electric Utility System Restoration Act (Securitization Act). This act establishes:

[A] mechanism by which the MS PSC may authorize and certify an electric utility financing order and the State may issue system restoration bonds pursuant to that financing order, the proceeds from which shall be used to securitize the system restoration costs and storm damage reserve levels of those electric utilities affected by Hurricane Katrina, thereby providing electric utility customers relief from traditional methods of recovering system restoration costs.¹⁷⁵

It is important to note that the Securitization Act applies to Hurricane Katrina only, and IOUs were allowed 120 days from the effective date of the Act (March 6, 2006) to petition the Mississippi PSC for a financing order authorizing the State Bond Commission to issue “system restoration bonds”.¹⁷⁶ As the bonds are issued by the State Bond Commission, the statute permits multiple financing orders to be incorporated into a single bond issue.¹⁷⁷ Within the 120-day window, the Mississippi PSC was required to either issue a financing order or reject the petition. Finally, upon issuance of the financing order, the IOU has 60 days to request the State Bond Commission to issue storm restoration bonds.¹⁷⁸ The order may be appealed through a direct appeal to the Mississippi Supreme Court.¹⁷⁹ The legislation requires that the State create separate funds, the Hurricane Katrina Electric Utility Customer Relief and Electric Utility System Restoration Fund and System Restoration Bond Sinking Fund to manage the bonds.¹⁸⁰

Like Florida, specific storm recovery property, a rate-payer charge, is created through the financing order. However, in contrast to Florida, the State of Mississippi is the owner of the property interest,¹⁸¹ and the full faith and credit of the State backs the bonds.¹⁸² As a result, the State, and not an IOU or SPE, issues and administers the bonds. The Securitization Act requires the State to pledge not to “alter the provisions of this Act which make the system restoration charge imposed by a financing order irrevocable” or alter the payments that bondholders will receive until the bonds are paid off fully.¹⁸³

¹⁷⁵ Mississippi, Mississippi Code Annotated, 1972: 77-5-903.
¹⁷⁶ Mississippi, Mississippi Code Annotated, 1972: 77-5-907.
¹⁷⁸ Mississippi, Mississippi Code Annotated, 1972: 77-5-907.
¹⁷⁹ Mississippi, Mississippi Code Annotated, 1972: 77-5-909
¹⁸⁰ Mississippi, Mississippi Code Annotated, 1972: 77-5-917.
¹⁸¹ Mississippi, Mississippi Code Annotated, 1972: 77-5-915.
¹⁸² Mississippi, Mississippi Code Annotated, 1972: 77-5-915.
¹⁸³ Mississippi, Mississippi Code Annotated, 1972: 77-5-955.
Mississippi Power

The 2005 hurricane season was the most expensive storm season experienced by both Mississippi Power (MPCO) and Entergy Mississippi, the two electric IOUs in the state. The response to cost recovery implemented by the State involved a combination approach, employing both federal CDBG funds and securitization.

MPCO restored power to its customers within the two weeks following Hurricane Katrina’s landfall.\textsuperscript{184} On October 21, 2005, the Mississippi PSC issued an interim order allowing MPCO to create a regulatory asset to accrue storm recovery costs.\textsuperscript{185} MPCO had initially sought to recover storm costs through securitization, and the Mississippi PSC addressed this request in an order issued on June 28, 2006. The MPUS and MPCO agreed to reduce the amount requested by approximately $7.7 million.\textsuperscript{186} Without offsetting the costs by using funds from the property damage reserve, MPCO’s recovery costs were slightly over $267.9 million.\textsuperscript{187} The Mississippi PSC found that this amount was just, reasonable, and prudently incurred and thus certified the entire amount for recovery.\textsuperscript{188} Further, the Mississippi PSC found that approximately $34.5 million in repair costs not completed at the time of the order could be included in the recovery, bringing the recoverable amount to over $302.4 million.\textsuperscript{189} Of this amount, approximately $292.8 million was allocated to the retail jurisdiction and the remaining $9.6 million to the wholesale jurisdiction. The wholesale allocation included the amount of recovery costs attributable to the Electric Power Associations (EPAs) as a part of the company’s cost of providing service.\textsuperscript{190}

The Mississippi PSC noted that MPCO’s $3.3 million storm reserve was insufficient to fund the recovery activities associated with a severe storm. Therefore, the stipulation agreement between the Mississippi PUS and MPCO included a provision to fund the reserve through securitization.\textsuperscript{191} According to the Mississippi PSC, “the funding of the reserve through Securitization Legislation will afford the Company and its customers a unique opportunity to better recover from future storm events with proportionately less impact to MPCO’s customers.”\textsuperscript{192}

Ultimately, the Mississippi PSC authorized the entire prudently incurred amount for securitization, in addition to an amount necessary to adequately fund the storm reserve.\textsuperscript{193} The Mississippi PSC ordered MPCO to file an application with the MDA to “obtain the Company’s allocation of CDBG funds as soon as

\textsuperscript{185} Mississippi, 94-UN-228 (August 4, 1994), 4.
\textsuperscript{186} Mississippi, 2005-UA-0555 (June 28, 2006), 6-7.
\textsuperscript{187} Ibid., 7.
\textsuperscript{188} Ibid.
\textsuperscript{189} Ibid., 8.
\textsuperscript{190} Ibid.
\textsuperscript{191} Ibid., 9.
\textsuperscript{192} Ibid.
\textsuperscript{193} Ibid., 11.
possible.”194 On July 3, 2006, MPCO filed for recovery of its system recovery costs and to fund the property damage reserve pursuant to the Hurricane Katrina Electric Utility Customer Relief and Electric Utility System Restoration Act.195 In Docket 2006-UA-352, MPCO requested $423 million, plus issuance costs and also requested the Mississippi PSC to enable additional funding of MPCO’s reserve fund by lifting the current $23 million cap.196 The order is scheduled for issuance no later than October 27, 2006.

**Entergy Mississippi**

Entergy Mississippi filed a request similar to MPCO’s for recovery with the State’s PSC to recover costs associated with the 2005 storms through securitization. Following agreement between Entergy Mississippi and the MPUS on June 6, 2006, the Commission adopted the joint stipulation and issued an order on June 28, 2006 certifying that approximately $89.1 million in recovery costs were prudently incurred and eligible for recovery either through securitization or through CDBG funds.197 This amount was reduced by $6.8 million to account for insurance proceeds and restoration costs that were not eligible for recovery.198 The order also directed Entergy Mississippi to apply to the MDA for CDBG funds before the Commission made a determination as to what funds may be securitized. In Docket 2006-UA-350, EMSI requested $81 million in restoration costs plus an additional $80 million to fund its storm reserves, plus financing issuance costs.199 The order is scheduled for issuance no later than October 27, 2006.200

**Community Development Block Grant Issues Result in Regulatory Delays**

The potential availability of CDBG funds to mitigate investor-owned utilities’ catastrophic storm recovery costs in the Gulf Coast states has delayed financing orders from the Mississippi PSC with regard to docket for Entergy Mississippi (EMSI) and Mississippi Power (MPCO). The two IOUs expected that these federal grant funds would be available when Hurricane Katrina cost recovery proceedings were initiated by the PSC. When the PSC made its determinations of allowable costs that could be recovered by the utilities, the Commission essentially directed the IOUs to work with the Mississippi Development Authority (MDA), the agency designated by the Governor to allocate the State’s share of CDBGs appropriated by Congress and administered by HUD. The MDA and HUD reached general agreement that the State’s IOUs would receive an allocation of $360 million when HUD approved the “Ratepayer and Wind Pool Mitigation Programs,

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194 Ibid., 11.
196 Ibid.
198 Ibid., 12.
199 Ibid, and researchers’ conversation with Executive Director MS PUS on October 25, 2006.
200 Ibid., 14., and researchers’ conversation with Executive Director of MS PUS on October 25, 2006.
Amendment 3” on July 27, 2006. However, sources at MPUS, MDA and HUD informed CIPP researchers that, as of October 24, 2006, no money had been released by HUD to the MDA and the utilities due to continued “word-smithing” of the required LMI waivers and notifications to the House and Senate Appropriations Committees.

Very early in 2006, it appeared that any CDBG allocation, the exact amount of which was unknown at the time allowable costs were approved, would be divided between the two electric IOUs in sums proportional to the Commission’s determinations. However, by the Spring of 2006, the Governor decided that the state’s two natural gas utilities would participate in CDBGs. While the exact distributions among the four energy utilities remain unknown as of October 25, 2006, it is expected that one of the gas utilities will receive a CDBG allocation of less than $200,000 and the other an allocation of about $2 million, potentially leaving the electric utilities with a combined shortfall of approximately $34 million which will be made up with storm bond proceeds.\(^{201}\)

The net effect of this situation means that the amounts the PSC will approve for securitization by the State Bond Commission (SBC) will be only marginally larger than the aggregate shortfall of $31 million estimated three months earlier. The PSC had scheduled final hearings on the two electric IOU storm securitization dockets at its regular business meetings for the months of August and September 2006, but has postponed the hearings until the next business meeting on October 3, 2006. Uncertainty on when and how much CDBG funds will be released and allocated is delaying closure on these two dockets.

Refer to this report’s section on “Federal Disaster Recovery Assistance: Community Development Block Grants” and appendices on MDA’s Recovery Action Plan amendments for more information on the interplay between Mississippi’s securitization process and HUD’s CDBG program.

Texas

Cost Recovery Statutory Innovations

On May 12, 2006, the Texas legislature passed new legislation allowing the use of securitization for storm cost recovery modeled on the mechanisms used to recover stranded costs. To prevent any further negative impacts to ratepayers, the act froze all rate cases until June 30, 2007, with new rates becoming effective no earlier than June 30, 2008.\(^{202}\) Rates cannot be modified in the State of Texas until next year –

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\(^{201}\) Sources: staff and officials at the Mississippi PUS and the MDA, week of 23 October 2006. The storm bonds issued by the State will probably be in a single tranche with a maturity of 15 years, although it appears that the SBC will have discretion on maturity over a range of 15 to 20 years and has sole authority on the timing of issuance. The state’s two natural gas utilities will not get any storm restoration financing from state issued bonds. Interestingly, while one of the gas utilities is investor-owned, the other is privately-held yet still is slated to receive CDBG funds.

\(^{202}\) Texas State Legislature, Called Session 2006, HB 163, 1.

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barring certain specific adjustments.203 The rate freeze does not apply to utilities that have not implemented customer choice.204

Under the new law, the Texas PUC will determine what hurricane reconstruction costs are recoverable and will securitize such costs with the same procedures used to securitize stranded costs.205 “Hurricane reconstruction costs” are defined as those costs which are “reasonable and necessary,” including capitalized costs, carrying costs, costs incurred after the filing of the request but before the next rate proceeding, and costs charged to a storm reserve.206 Cost recovery is limited to recovery associated with Hurricane Rita, and any costs must be reduced by the amount of governmental grants, insurance proceeds, or any other source of funding which compensates the utility for hurricane recovery.207 However, a formal rate proceeding is not required to determine the amount of recoverable hurricane-related costs.208 If the timing of other funding prevents the Texas PUC from reducing the securitized amount, the difference will be taken out of the utility’s base rates at the next rate proceeding.209 It remains the Commission’s responsibility to ensure that greater tangible benefits result from securitization than would have been achieved without the issuance of bonds.210

The Texas PUC has 150 days to certify the applying utility’s costs as reasonable or unreasonable,211 and a financing order must be issued within 90 days following certification detailing the costs to be recovered, the bonds to be issued, and the time period for bond recovery, which may not exceed 15 years.212 The financing order is irrevocable once issued and, if the Texas PUC determines that it is in the public’s best interest, a bond issuance can be refinanced later by a new securitization financing order.213 Charges are reviewed at least once a year to ensure that the revenue stream backing the bonds is being neither under-collected nor over-collected.214 One difference between stranded cost securitization and hurricane cost

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203 Ibid.
204 Ibid., 2.
205 Ibid., 3.
206 Ibid., 3 & 7. [The term “reasonable and necessary” is not defined, nor is it distinguished from the term “reasonable and prudent” or “prudently incurred” which is used to limit recoverable utility expenditures in other states. Using the common meanings of the terms, some difference is apparent. “Reasonable” simply means being in accord with reason and not being excessive (Source: http://www.m-w.com/dictionary/reasonable). “Prudent” means showing the qualities of skill and good judgment in the management of resources, while “necessary” is less demanding and merely requires that something is absolutely needed (Source: http://www.m-w.com/dictionary/prudence). An expenditure can be required by the circumstances and yet not be the best possible alternative among all of the available options. While these are the same considerations usually made when determining prudence, the standard appears slightly lower. The term “reasonable and necessary” mirrors the language used in the stranded costs recovery statutes (Texas, Vernon’s Code of Texas Annotated, Utilities: 39.409.), as do the procedures used for the issuance of hurricane cost financing orders (Texas, Vernon’s Code of Texas Annotated, Utilities: 39.460.).]
207 Texas State Legislature, Called Session 2006, HB 163, 4.
208 Ibid., 8.
209 Ibid., 4.
210 Ibid., 3.
211 Ibid., 8.
213 Ibid.

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securitization is that that qualifying hurricane-related costs are allocated to customers in the same manner that the corresponding facilities are allocated in the utility's base rates.\textsuperscript{215} To provide the state regulatory pledge required by law, the Texas PUC must declare the surcharge non-bypassable.\textsuperscript{216}

If the Texas PUC determines that recovery of an electric utility’s reconstruction costs using securitization is not beneficial to ratepayers and securitization proceedings have not begun, the Texas PUC is required to allow the utility to recover its costs through an appropriate customer surcharge mechanism.\textsuperscript{217} The surcharge will automatically expire when new rates are implemented at the next rate base proceeding.\textsuperscript{218} This is also a new option, as before this legislation a utility would need to go through a rate proceeding in order to attach a storm-related surcharge to customer bills.\textsuperscript{219}

\textit{Entergy Gulf States}

On January 17, 2006, Entergy Gulf States (EGSI) updated its responses to the Commission’s initial questions.\textsuperscript{220} First, EGSI raised its estimate of its Hurricane Rita costs to $369 million.\textsuperscript{221} Second, EGSI included CDBG funds among its possible sources of external funding,\textsuperscript{222} and stated its intention to pursue as much of the CDBG funds allocated to Texas by HUD as possible to finance its storm recovery costs.\textsuperscript{223}

On March 15, 2006, EGSI again updated its responses to the Texas PUC’s questions about Hurricane Rita.\textsuperscript{224} EGSI’s estimate of Hurricane Rita costs stayed level at $369 million, though it did state that it had lost an additional $1.9 million to customer write-offs.\textsuperscript{225} EGSI stated that its expenses were eligible for the CDBG program, but also noted that only $74.5 million had been allocated to Texas.\textsuperscript{226} EGSI’s insurance coverage was now estimated to amount to $64 million.\textsuperscript{227} EGSI also indicated that its credit rating outlook had been upgraded due to analysts’ belief that regulators would allow for substantial storm recovery, and that it would be able to provide a final estimate of its costs during May 2006.\textsuperscript{228}

EGSI filed a third set of supplementary responses to the Texas PUC on May 15, 2006.\textsuperscript{229} EGSI offered a new estimate of $415 million for its Hurricane Rita recovery costs.\textsuperscript{230} The utility indicated that it

\begin{footnotesize}
\textsuperscript{215} Texas State Legislature, \textit{Called Session 2006}, HB 163, 6.
\textsuperscript{216} Ibid., 7.
\textsuperscript{217} Ibid., 6-7.
\textsuperscript{218} Ibid., 7.
\textsuperscript{219} The legislation referenced is HB 163 (Texas State Legislature, \textit{Called Session 2006}, HB 163).
\textsuperscript{220} Texas, 32003 (January 17, 2006), 1.
\textsuperscript{221} Ibid., 2.
\textsuperscript{222} Ibid., 3.
\textsuperscript{223} Ibid.
\textsuperscript{224} Texas, 32003 (March 15, 2006), 1.
\textsuperscript{225} Ibid., 2.
\textsuperscript{226} Ibid., 5.
\textsuperscript{227} Ibid.
\textsuperscript{228} Ibid., 6.
\textsuperscript{229} Texas, 32003 (May 15, 2006), 1.
\textsuperscript{230} Ibid., 2.
\end{footnotesize}
was actively seeking a portion of CDBG funds for Texas.\textsuperscript{231} EGSI also indicated that it would try to take advantage of the new Texas securitization bill as soon as possible.\textsuperscript{232}

On July 5, 2006, EGSI applied for certification of its Texas-jurisdictional Hurricane Rita costs.\textsuperscript{233} The purpose of this determination was to decide which costs were eligible for recovery or securitization, to authorize carrying costs, and to approve the manner in which the costs were functionalized among the different customer classes.\textsuperscript{234} EGSI applied to have over $393 million in Hurricane Rita costs certified.\textsuperscript{235} EGSI explained that it had testimony to support both its estimate of its costs and how it derived that figure out of the larger amount of total Hurricane Rita-related damages – $561 million – across its service territory.\textsuperscript{236} EGSI also explained that it had testimony to demonstrate why Rita was so destructive and what actions and plans the utility implemented before the storm to reduce the damage.\textsuperscript{237}

On August 28, 2006, EGSI notified the Texas PUC that HUD would be distributing $428 million in disaster funding to Texas for Hurricanes Katrina and Rita costs. A later determination will be made regarding what portion of the CDBG funds will be allocated to EGSI. The next hearing in this matter is scheduled for early November 2006.\textsuperscript{238}

**Summation**

All of the states examined for this research project resorted to securitization, enabled by quite specific new state statutes, to provide Commissions with a new tool that could mitigate the monthly costs utility customers otherwise would bear under “traditional” methods. In three of the states – Florida, Louisiana, and Texas – a private sector entity that is at arm’s length from the utility will issue the bonds. That Special Purpose Entity is “bankruptcy-remote”, allowing the bonds to achieve an AAA rating that is more or less required by new laws and regulations. These three states provide a regulatory pledge that each state will undertake no action or activity which interferes with the bonds. Mississippi chose a different approach: the State will issue bonds that are authorized by its securitization statute and will provide a “full faith and credit” pledge. It is expected that these bonds will have the same rating as the State, currently Aa3, which may make the costs to customers higher in Mississippi than in the other states that chose a “private sector” approach. At least two states are aggressively pursuing the use of Community Development Block Grants, which could significantly mitigate costs to customers by shifting the burden to all federal taxpayers. Yet there is

\textsuperscript{231} Ibid., 3.
\textsuperscript{232} Ibid., 4.
\textsuperscript{234} Ibid.
\textsuperscript{235} Ibid.
\textsuperscript{236} Ibid., 3.
\textsuperscript{237} Ibid., 7.
\textsuperscript{238} Cruthirds, The Cruthirds Report.
reluctance, even in Florida, for policymakers and ratepayers to deal with future disasters that they know will occur in a more forward-looking manner, an example of which can be found in the testimony regarding the size of storm reserves in the FPL securitization matter.

A New Approach to Cost Recovery: Securitization

State policymakers, commissions, and rate regulated electric utilities have turned to “securitization” – that is, the issuance of bonds with legal maturities generally within seven to 15 years – to hold down the rate of increase in customers’ monthly bills. Instead of anticipating and paying for future costs through accrual-type “rainy-day funds” or paying for costs after they have been incurred through accounting techniques and/or “temporary” surcharges, securitization provides a utility with a more immediate influx of cash, the repayment of which is spread over a comparatively long period of time. Customers invariably pay the full, allowable costs of both predictable charges, such as stranded cost recovery in response to a regulatory change, and unforeseen costs such as hurricanes, other large natural disasters, and sabotage and terrorism. When such charges are sufficiently high, it is difficult both politically and practically to recover costs over a short period of time. For example, in the case of temporary storm recovery surcharges cash infusion to the utility trickles in over the life of the surcharge and often results in higher total transactional costs to the utility and, ultimately, its customers. Securitization may provide other benefits that reduce the total costs for customers and utilities, an example of which is more favorable tax treatment.

Starting in the mid-1990s, state officials and utilities turned to a relatively new financing mechanism generically called “Asset-Based Securities”. The first securitization issues occurred in the State of Washington to pay for costs associated with demand-side management implementation in June 1995 and 1997. Beginning in late 1997, issuances occurred in California, Connecticut, Illinois, Massachusetts, Michigan, Montana, New Jersey, New Hampshire, Pennsylvania, and Texas for the purposes of rate reduction and stranded cost recoveries associated with “deregulation”. Starting in 2004, securitization was used for new purposes, such as paying for deferred balances (Rockland Electric, New Jersey) and to refinance a regulatory asset [Pacific Gas and Electric (PG&E), California]. In 2006, securitization issues are pending to pay for environmental controls (Allegheny Power, West Virginia, and Wisconsin Electric Power, Wisconsin), stranded costs (American Electric Power, Texas), deferred balances (Jersey Central Power & Light, New Jersey), and storm recovery – the topic of this report (Florida, Mississippi, Louisiana, and Texas). From 1997 through 2005, state officials have authorized 36 securitization issues for electric utilities with the total value of all issues over $36.3 billion.239 Even where the utility has gone bankrupt after bonds were issued, as was the case of PG&E,

bonds continued to receive an AAA rating, and thus “least cost” financing, the non-bypassable requirement was achieved, and investors’ expectations were fully protected. Still, ratings agencies caution that securitization is not a panacea for every major utility cost recovery issue and should not be overdone.240

Technical literature on securitization often refers to a general class of securities for which storm recovery bonds is a subset of both Utility Tariff Bonds (UTBs) and, more broadly, Asset-Backed Securities (ABS).241 According to direct testimony of Jay Kim, Managing Director in the Asset Securitization Group, Barclays Capital Inc., the investment banking division of Barclays Bank PLC, when appearing earlier this year before the Florida Public Service Commission on the Gulf Power securitization docket (#060154-E1), “ABS and corporate bonds differ substantially in their legal form, credit profile and other investment characteristics including secondary market liquidity and their respective new issue markets.”242 A close analogue to storm recovery bonds in the electric power sector are rate reduction bonds that have been used repeatedly over the past decade to finance stranded cost recovery. The most important distinction from other corporate bonds in the case of storm recovery bonds is that specific revenue streams from various customer classes that the Commission has authorized the utility to collect on a monthly basis are being securitized. As stipulated by most state laws, the utility is the original owner of these revenue streams and, as required by state law and the Commission’s final financing order, the utility must sell the entire rights to these revenues to a bankruptcy-remote Special Purpose Entity (SPE). The SPE issues the AAA-quality bonds and uses the proceeds to pay principal, interest, and other closely-defined servicing fees and administrative expenses associated with the bonds.243 The bonds are expected to achieve, and in reality do achieve, an AAA rating signifying the very low risk associated with the bonds because investors look solely at the assets of the SPE for the payment of principal and interest; the integrity of the assets is backed by a state regulatory pledge not to take any action which could interfere with the SPE’s assets – i.e., the storm recovery fees collected monthly by the utility from its customers and simultaneously transferred to the SPE.244 The regulatory pledge assures uninterruptible revenue flows due to the non-bypassable nature of continued collection from ratepayers. In contrast, when typical corporate bonds are issued it is the tangible assets of the issuer, not a bankruptcy-remote, legally distinct special purpose entity, which are being securitized absent any state regulatory pledge.

241 Some experts, such as Joseph S. Fichera, CEO of Saber Partners LLC, argue that the type of public utility securitization being discussed in this report is not within the conventional definition of ABS because public utility securitization has “no pool of receivables, financial assets or other complexities.” This report will use the term ABS interchangeably with “Utility Tariff Bonds” (UTB) which appears to be emerging as a new term of art to describe the kind of bond transaction being discussed here.
242 Florida, 06-0601 (February 22, 2006), 9.
243 This generalization of state laws on storm recovery securitization bonds does not apply in the case of Mississippi, whose securitization processes will be discussed separately from the other three states.
244 It is important to note that most state securitization laws provide a state regulatory pledge which is not the same as a full faith and credit guarantee. What differentiates Mississippi’s securitization law from those of Florida, Louisiana and Texas (and most other states) is that the state of Mississippi does provide a full faith and credit pledge and an instrumentality of the state, not a private-sector SPE, issues the bonds.
Key Provisions: Federal Requirements

In general, to achieve “lowest cost” financing, storm cost securitization starts with a specific statutory grant from a state legislature. That statute almost always includes (1) a state pledge of non-impairment; (2) stipulates that any resulting Commission financing order must be final and irrevocable; (3) provides for automatic adjustments (formulary true up/down) on at least a semi-annual basis; and (4) requires certain actions from the Commission, including “least cost alternative” considerations and an unusual degree of involvement and oversight after the final order, up to and including actual storm bond offerings. Further, the statute (5) creates a new, intangible property right for the utility derived from charges on customers that is then (6) required to be sold or transferred to the SPE. That charge is (7) “non-bypassable”, meaning that, irrespective of future changes in the regulatory environment or the business organization of the utility including but not limited to mergers, acquisitions, and bankruptcy reorganization, the charge must be continue to be collected from customers by the utility and/or its successor entity(-ies).

To obtain tax-free status and other benefits, securitization regimes must meet the new six-part test found in Federal Internal Revenue Service (IRS) Revenue Procedure 2005-62, 2005-37 IRB 507 – collectively, the “Revenue Procedure” – issued September 12, 2005. Prior to this Revenue Procedure, only securitization bonds limited solely to stranded cost recovery clearly were eligible for federal tax-free status. IRS rulemaking has the effect of opening up securitization to storm cost recovery and a range of other rate-reduction purposes:

Under the Revenue Procedure, the public utility will not recognize gross income upon receipt of a financing order that creates the intangible property right, of upon the receipt of cash or other consideration for the transfer of that property right to the [SPE], or upon the receipt of cash or other consideration issued in exchange for the debt instruments issued by the [SPE].

With the issuance of the Revenue Procedure, public utilities will not need to obtain private letter rulings [from the IRS] in advance of issuing their bonds secured by future tariffs but may proceed directly to the market if they have received the necessary financing order pursuant to the State legislation. However, care must be taken to assure that the State legislation meets all of the requirements of the Revenue Procedure . . . and that the intangible property rights created by State legislation are not subject to the lien in any of the utility’s pre-existing secured debt instruments.

The Revenue Procedure significantly expands the options available to utilities for financing current costs that are recoverable through rates. For example, public utility companies in the Gulf states area hit by Hurricanes Katrina and Rita would be able to take advantage of the Revenue Procedure to recover hurricane related costs if applicable State

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legislatures take appropriate action. In addition, other utility tariffs that could support a securitization could include fuel surcharges, construction of transmission facilities, generation facilities and/or pollution control facilities and any other separately identifiable recoverable costs.246

As the June 2005 Florida storm securitization law and the September 2005 Revenue Procedure are congruent, this assures that any storm bonds that might be issued will receive tax-free treatment because the Florida statute has specific requirements mirroring each of the IRS’ six-part test. However, prior to IRS rulemaking that had the effect of liberalizing the use of securitization, on December 22, 2004 the US Securities and Exchange Commission (SEC) issued final rules for “Regulation AB”, which affects “all public asset-back issuances commencing after 31 December 2005.”247 At the time, major federal securities laws were written as part of President Franklin D. Roosevelt’s New Deal; the ABS market did not exist. As the ABS market was created in the late 1980s and expanded significantly thereafter, Congress and the SEC revised the registration requirements piecemeal. Regulation AB was seen as a consolidation and an updating by the SEC to meet the reality of the modern ABS markets; it also may be viewed as a modest restraint against the expanding uses of ABS and ABS-derived instruments, such as UTBs which provide investors and markets with better information and greater transparency and require issuers to adhere to new accountability requirements.

Regulation AB imposes three key changes for issuers of regulatory jurisdictionable ABS: (1) changes were made to disclosure requirements and far greater disclosure now is required via new SEC Form S-3; (2) existing SEC 10-K reporting requirements were changed and a new monthly report, Form 10-D, was created that must be filed as early as January 2006; and (3) a new annual servicing assertion and a certified public accountant’s attestation report were created. Implementation of Regulation AB may be of value to public service commissions and investors because it consolidated hitherto fragmentary ABS reporting and required monthly, rather than annual, filings. Regulation AB will also provide commissions and investors with a more neutral source of information and reduce their reliance on educational and marketing materials prepared for them by financial advisors and outside consultants.

Securitization Processes

The utility that is specifically authorized to collect identified sums of money from its customers is the original owner and initial servicer of the special property right and interest. It then sells or transfers that right

246 Cudd, Client Alert, 2. [Emphasis added.]
247 Mike Seelig, David Lukach, Thomas Know, Understanding Regulation AB, NY-PD-05-1070A (PriceWaterhouseCoopers, December 2005). [Most ABSs that were issued prior to the effective date are grandfathered into pre-AB regimes, and privately-issued securitizations are not subject to Regulation AB.]
to the SPE, which for technical reasons usually is organized as a Delaware Limited Liability Company (LLC) or Delaware statutory business trust. In the case of LLC organization, the utility company is the sole member of the SPE, but at least one manager of the SPE must be independent of the utility. The SPE is considered to be transactionally arm’s length from the utility and is “bankruptcy-remote” from it. Nonetheless, typically it is the utility, using a separate set of books and records-keeping, that administers the continued collection of storm bond charges from customers after the property and interest is held by the SPE. The utility also provides other bond servicing functions for a fee determined by the Commission in its final order. In its role as issuer, the SPE finances the purchase of the utility’s special property by selling storm recovery bonds in amounts and under terms approved by the Commission. Even the most expertly-staffed commissions often lack the experience and specialized skills to structure and execute a successful bond offering that meets both the letter and spirit of securitization statutes and a commission’s order. Accordingly, a commission usually retains the services of at least one financial advisor. The financial advisor typically facilitates technical matters among a commission, SPE, and underwriters. The diagram below illustrates process stages and financial flows in a storm securitization bond issue. The solid lines reference process, property, or monetary flows whereas the segmented lines refer to flows communication, information, or data.

**Typical Characteristics of Storm Recovery Bonds**

Having already described the differences between ABS and other corporate bonds, storm recovery bonds also have other distinct characteristics. Typical bonds have a single payment of principal on the
specified date of maturity. Storm bonds and other specialized UTBs usually are structured to make principal and interest payments on a monthly or quarterly basis. As such, these are amortizing securities in which principal is retired during the life of the transaction or “payment window”. UTBs, generally, and storm recovery bonds, specifically, are almost always offered to and are purchased by institutional, not “retail”, investors. Typical institutional investors for these bonds vary by the bonds’ term of maturity or “tenor”, which varies according to the technical structure of each “tranche”, meaning related securities offered at the same time that typically have different reward, risk, and maturity characteristics.248 CIPP researchers’ conversations with Florida Commission staff indicate that this will be the case when FPL storm recovery bonds are issued in late October or November of 2006. FPL’s storm bonds are expected to be issued in three or four tranches with expected maturities of two, five, seven, and 10 years – each well within the 12-year legal lifespan for all bonds.249

According to Joseph Fichera, CEO of Saber Partners, LCC, a New York City financial advisory firm which has been retained by the Florida and Texas Commissions:

A defining and common feature of these securitization transactions is that they all have been made possible by specific enabling state legislation that has established a legal framework for the creation of a new type of intangible property right under law. This new intangible property will, in general, initially be owned by the utility. Like any other property owned by the utility, this new property right can be pledged as collateral in a financing. In this case, the property right created is the right to bill, charge and collect a specific charge on some or all of its retail consumers in a given electricity transmission and distribution service territory. Securitization creates a separate and independent credit based on the risk associated with the cash flows from the pledged property that supports the payment of principal and interest to investors. As a result, securitized debt instruments do not burden the assets or revenues of the sponsoring utility and instead are payable solely from the pledged property [that is transferred to the SPE]. This means ratepayers are solely responsible for payment. Consequently, the financing is unlike any of the utility’s other obligations. The economic burden of repaying these securitized bonds falls squarely on the ratepayers in the service territory; hence, they are aptly referred to as “ratepayer-backed” bonds. It is effectively off-balance-sheet and non-recourse to the utility. The utility is fully protected. This means that the utility can finance the asset or expense in question with nearly 100 percent debt rather than its normal capital mix of about 50 percent debt and 50 percent equity without any impairment of its credit structure. By separating the operating utility from the [SPE] and isolating the cash flow, the credit associated with ratepayer-backed bonds will be evaluated by investors as independent of the sponsoring utility and [its traditional debt].

248 Money Market funds and insurance companies are by far the largest purchasers of ABS bonds where tenor is between three and nine years.
249 Source: CIPP researchers’ conversation with senior Florida Public Service Commission staff (September 12, 2006).
Critical Electric Power Infrastructure Recovery and Reconstruction:
New Policy Initiatives in Four Gulf Coast States After 2005’s Catastrophic Hurricanes

Conventional utility debt has numerous risks associated with its repayment. Those risks will not be present in connection with ratepayer-backed bonds.250

Use of Utility Tariff Bonds to Finance Ratepayer Cost Reduction: Key Issues

At the beginning of this section, several potential benefits of securitization using UTBs were described, including:

- Providing “immediate” cash as opposed to almost all other forms of cost recovery, with the exception of robustly-funded storm reserves that exceed and can be expected to continue to exceed all allowable costs.
- Providing “least cost” financing compared with other forms of utility borrowing. Markets, not regulators, determine the real price of money; private investors acting from market signals, not ratepayers initially, provide capital.
- Specific statutory authority that removes uncertainty about an intangible asset and reduces regulatory uncertainty in PSC securitization processes.251
- Relatively lower cost to the utility’s customers when compared to other forms of utility cost recovery measures; reduces the “rate shock” of temporary surcharges.
- True-Ups/True-Downs regulatory costs are reduced to simple mathematical calculations.
- If the utility would otherwise not earn a profit on the regulatory asset being securitized, the bonds eliminate a non-earning asset.252

Experts suggest that there also may be some downsides to securitization. For example, Ellen Lapson, Managing Director of Fitch Ratings, suggests that one of securitization’s benefits is that it can be used to eliminate a non-earning asset. Conversely, Ms. Lapson cautions against using UTBs to finance an earning asset. She also cautions that if a large charge is being securitized, doing so may have the undesired consequence of “reducing future pricing flexibility and subordinates unsecured bondholders, so don’t overdo it.”253

There is general consensus that properly structured UTBs are acceptable alternatives to “traditional” cost recovery approaches for such issues as stranded costs and environmental remediation. Moreover, independent bond rating firms have commented favorably on the use of securitization for storm cost recovery. Rating firms have commented with some skepticism, however, on the use of securitization to deal

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250 Direct testimony of Joseph S. Fichera, Appearing on Behalf of Staff, Before the Florida Public Service Commission. Docket No. 060038, (March 31, 2006), 9-11. [Saber Partners also has performed “engagements” for the states of New Jersey, Vermont, California, West Virginia, Wisconsin, the US Securities and Exchange Commission (SEC) and Exxon-Mobil Corporation. Further information about Saber can be obtained on its website, http://www.saberpartners.com/index.html.]
251 Lapson, Utility Tariff Bonds, 6.
252 Ibid.
253 Ibid.
with fuel costs, or “deferred energy costs”, and using UTBs to finance a “permanent layer of utility capital structure” – both of which are the kinds of potential uses advocated by Robert Cudd of LeBouef Lamb. CIPP research suggests that the market for utility securitization offerings might be limited. For example, Florida commission staff seek to time the issuance of FPL bonds of $708 million after American Electric Power’s pending $1.3 billion stranded cost offering, but hopefully before pending environmental control offerings from Wisconsin Electric Power totaling $450 million and Allegheny Power costs of at least $381 million, presently being revised upward. Florida Commission staff suggest that the market’s pricing of FPL’s bonds could be adversely affected if the bonds are issued after the pending environmental issues.

Ms. Lapson stated that Fitch cautions that care should be taken to “limit the size of the total special tariff component” – in other words, the aggregate amounts securitized as a portion of the customer’s total bill:

\[
\text{In 58 percent of [all] “AAA” transactions, the total special tariff building component amounted to 8 percent or less of total customer cost. Fitch expects that the special tariffs in “AAA” transactions will aggregate well below 20 percent of the total customer utility cost.} \]

However, securitization advocate Joseph Fichera of Saber Partners notes that the “Idaho legislature authoriz[ed] securitization for any utility purpose up to 40 percent of balance sheet.”

The anticipated next phase of CIPP research will examine actual market results for the novel uses of securitization for storm costs and environmental costs for which bond issues are pending at this time. Most utility securitization issues occurred the context of “one-time affairs”, such as stranded cost recoveries in 1997 ($6.1 billion), 1998 ($4.3 billion), 1999 ($7.8 billion), and 2001 ($8.4 billion). As a direct result of the finalization of state “deregulation” activities, the dollar volume of utility securitizations fell off dramatically from peak activity years during 2002, 2003, and 2004 ($1.6 billion, $0.7 billion, and $0.8 billion respectively). Saber Partners’ estimate for 2006 utility securitizations – which does not include possible issuances in Louisiana, Mississippi, and Texas for non-stranded cost purposes – is $3.6 billion, most of which is slated for storm and environmental cost recoveries. Unlike using securitization to pay for stranded costs or the costs of installing scrubbers, storms are not “one-time affairs” nor are other novel uses of securitization to pay for increases in the price of fuels. If, for example, securitization is used repeatedly to pay for storm costs that are recurring in nature, at what point does Fitch Ratings’ caveat about limiting the size of the special tariff component to less than 20 percent come into play and how will bond markets respond? How, too, will customers respond if, as might be expected, multiple UTB charges begin to accumulate on their bills? Is

\[254\text{ Ibid., 7. [Emphasis added.]}
\[255\text{ Ibid., 5.}
\[256\text{ Fichera, Utility Securitization, 23.} \]
there a point at which pushing recoveries for past and current costs 10 or more years into the future does not make for good economics and public policy?

**Securitization in Mississippi**

Unlike the other three states examined in this report, the legislature in Mississippi took a very different approach to securitization in its authorizing statute. First and foremost, if storm recovery bonds are issued in Mississippi — and indications are that bonds will be issued in late 2006 or early 2007 — they will be offered for sale to investors by the State Bond Commission (SBC) and will be backed by a full faith and credit pledge of the State.

On July 31, 2006, Moody's Investors Service reaffirmed Mississippi's Aa3 General Obligation Bond Rating and stated that it expected the State's credit outlook to be stable. This rating is two gradients below the AAA rating which will be achieved by bonds issued pursuant to commission financing orders in the State of Florida. Unless the ratings agencies revise Mississippi’s bond rating to AAA before the State issues storm recovery bonds, the storm recovery bonds issued by the State will cost Mississippi's ratepayers comparatively more, dollar-for-dollar, than storm bonds issued by a private-sector special purpose entity which achieve an AAA rating.

Second, the Mississippi securitization law is sunsetted; it applies only to storm recovery costs that the PSC has found to be reasonably and prudently incurred as the result of Hurricane Katrina. The statute cannot be used for other 2005 storms or any future storms. This assures that Mississippi utilities will not be able to issue UTBs for other purposes unless specifically authorized by future legislation.

Third, based upon information provided to CIPP researchers by MPUS and other experts, the State Bond Commission will not have separate issuances for Mississippi Power and Entergy Mississippi, but rather will aggregate the Commission-approved recovery amounts for both utilities into one issue.

**Federal Disaster Recovery Assistance: Community Development Block Grants**

The Community Development Block Grant (CDBG) program was created by an act of Congress and is authorized under Title I of the Housing and Community Development Act of 1973 (P.L. 93-383). CDBGs are administered by the US Department of Housing and Urban Development (HUD), and funded by annual appropriations to the program from Congress. In addition to CDBG Entitlement Community Grants that

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257 Moody's is one of the three large independent ratings agencies which engages in research and the provision of financial analysis and information on global capital markets. The other two ratings agencies are Fitch's and Standard & Poor's. While the ratings nomenclature varies slightly among the three firms, the actual ratings and outlooks are generally very consistent among the ratings agencies.

258 While Mississippi’s bond rating did not slip post-Katrina, Moody's did place the state on its negative watch list, which typically is a ratings firm's first step in degrading the State's bond rating. Had Mississippi not adjusted its fiscal policies after Katrina, the State likely would have had its rating diminished, which is what occurred in Louisiana and the City of New Orleans.
are focused on larger cities, other HUD programs include the State Administered CDBG, also known as the Small Cities CDBG, and CDBGs for the Insular Areas and the Colonias; these too are funded by annual appropriations. The main components of CDBG deal with a wide range of development needs which are addressed in the form of annual formulary grants delivered to 1,180 units of local governments and the States and generally must meet Low- and Moderate-Income (LMI) means-testing.

This section of the report focuses on HUD’s Disaster Recovery Assistance CDBG program, which “provides flexible grants to help cities, counties, and States recover from presidentially declared disasters, especially in low-income areas, subject to availability of supplemental appropriations.” Congress has chosen to use the CDBG vehicle to bridge the gap between emergency and temporary assistance provided by the Robert T. Stafford Disaster Relief and Emergency Assistance Act, commonly referred to as the Stafford Act, and federal assistance that is intended to be used for longer term, post-emergency reconstruction and recovery. In at least two states examined in this report, state officials plan to use a portion of CDBG funds received from HUD to provide assistance to Investor-Owned Utilities (IOUs).

Past use of CDBGs to provide federal grant money to IOUs has been exceptionally limited. CIPP researchers have found only two past instances where Congress has made supplemental appropriations to the CDBG program in order to provide assistance to for-profit critical infrastructure. Both have been controversial, with expectations of Congressional sponsors, utilities, and ratepayers unmet. An appendix to this report, CDBG Utility Precedence, describes in detail these two instances. Issues of law, economics, and policy raised as a result of the two previous uses of these grants remain salient.

In two FY 2006 emergency supplemental appropriations acts, P.L. 109-148 (December 30, 2006) and P. L. 109-234 (June 15, 2006), Congress appropriated $11.5 billion and $5.2 billion respectively to the CDBG program for use on recovery projects in geographic areas corresponding to presidential emergency declarations for Hurricanes Katrina, Rita, and Wilma. The table below provides a state-by-state breakout of CDBG allocations made by HUD for both supplementals.

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260 Ibid.

This document represents a preliminary assessment based upon publicly-available sources of data and information for ongoing storm cost recovery processes in selected Gulf Coast states. The views expressed herein are those of the authors and may not represent those of the institution.

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* Included for reference purposes only

According to Brian Sullivan, a senior HUD public affairs official who specializes in information requests for hurricane-related CDBGs, the overall focus of the first supplemental is on “concentrated areas of distress”, whereas the focus of the second is “unmet housing needs”. This suggests that critical infrastructure requests may receive a lower weighting in the second tranche of federal CDBG funds than the first. Whether a state “action plan” has been approved or not can be misleading; in reality, there likely will be more than one, if not several, state action plans submitted to HUD by each eligible state. In interpreting the data in the above table, Mr. Sullivan cautions that states are in fact submitting piecemeal plans, some of which are broad with regard to critical infrastructure while others are more specific. Gulf Coast states have not, as of late September 2006, submitted action plans and/or received HUD approval for such plans which, when summed, are equal to the amount the Congress appropriated. At this time, the only state with an action plan in which CDBG funds have been specifically approved for IOU infrastructure is Mississippi, for a total of $360 million in the context of its Ratepayer Mitigation Program. However, HUD has not yet disbursed CDBG funds associated with the Ratepayer Mitigation Plan due to sensitive matters regarding waivers.263

It is not just in Mississippi that CDBGs have been enthusiastically embraced as a means to pay for IOU infrastructure damaged by the 2005 hurricanes. For example, during its September 13, 2006 meeting,

261 Mark Ballard, “Utilities to get some cash for recovery,” Capital News Bureau (September 19, 2006), Available at: http://www.2theadvocate.com/news/business/3957551.html. [State commission staff view this article as accurate with regard to a ballpark figure for IOU assistance.]

262 “Ratepayer & Wind Pool Mitigation Programs: Recovery Action Plan Amendment 3, Mississippi Development Authority (July 27, 2006) [Please refer to this report’s section on “New Storm Cost Recovery Approaches” for a discussion of the interplay between PSC storm recovery activities and block grants.]

263 Sources: Conversations with attorneys and staff at the Mississippi Public Service Commission, the Mississippi Development Authority, and federal officials in the US Department of Housing and Urban Development’s General Counsel and Public Affairs Offices (September 19-22, 2006).
the Louisiana PSC adopted a motion urging Governor Blanco and the Louisiana Recovery Authority (LRA) to dedicate a portion of Louisiana’s CDBG funds to electric and gas utilities:

"The Commission voted unanimously to adopt a resolution asking Governor Kathleen Blanco and the LRA to allocate CDBG funds to electric and natural gas utilities to compensate them for their extraordinary storm restoration costs and to mitigate the rate impact to consumers. Commissioner Sittig spoke forcefully in support of the motion, contending a significant allocation of CDBG funds to the utilities would benefit everyone in Louisiana. He said he couldn’t “put it any stronger” and asked anyone who knows anyone to pick up the phone and lobby to explain the seriousness of the situation to the Governor and the LRA." 264

It is not possible to conclude at this time that HUD and governors in the other Gulf Coast states will not use some CDBG funds for IOU infrastructure storm cost recovery. During the extension of the grant which sponsored this research, CIPP intends to assess actual amounts and uses of CDBG funds that may be provided to IOUs and/or their retail or wholesale customers.

Community Development Block Grant Eligible Activities

In the past, controversies have arisen as to whether CDBG funds appropriated by Congress may lawfully be used by IOUs and other for-profit entities. Title 24 United States Code, Chapter V, Part 570, Subpart C “Eligible Activities” provides guidance on this question. Quoting directly from Title 24, Volume 3 (last revised April 1, 2004):

§ 570.201 Basic Eligible Activities, subparagraph (2). In order to alleviate emergency conditions threatening the public health and safety in areas where the chief executive officer [typically, the governor] of the recipient [typically, a State] determines that such an emergency condition exists and requires immediate resolution, CDBG funds may be used for . . .

(i) Privately owned utilities. — CDBG funds may be used to acquire, construct, reconstruct, rehabilitate or install the distribution lines and facilities of privately-owned utilities, including the placing underground of new or existing distribution facilities and lines.265

265 Available at: http://a.akamaitech.net/7/257/2422/12feb20041500/edocket.access.gpo.gov [Accessed September 21, 2006]. [CIPP researchers contacted HUD’s Office of General Counsel seeking information on the regulatory development and history of subparagraph(l), specifically when this eligibility criteria was incorporated into basic eligible activities and if (3)(l) might be the result of statutory or report language from Congress. Mr. Bob Kenison of the GC’s office stated that the generic term “utilities” was included in Section 105(a)(2) in the original 1974 Act. Specific regulatory focus occurred during the Carter Administration and regulations pertaining to utilities were “modified slightly.” In 1983 reauthorization activities, the Congress dropped explicit mention of “utilities” from the statutory language but regulations authorizing utilities among Subpart C Eligible Activities continued even though the specific use of the word “utilities” was out of the statute.]
Subparagraph (l) makes clear that the distribution infrastructure of IOUs is eligible for CDBG funds. However, problems and controversies arise from the politics of emergency supplemental appropriations and from attempting to conform fundamental CDBG requirements to the intended use. As the senior attorney at HUD’s Office of General Counsel noted, “utilities do not need a waiver regarding eligibility but LMI [low-moderate income] waivers are needed.”266 His recollection of the flawed implementation of CDBG funds to pay storm costs associated with the early 1998 ice storms was that the LMI test was impossible to meet; “[o]ne household might fit the requirement and the neighbor next door could be rich . . . we could not tell. Too tough.”267 Some officials believe that “word-smithing” is responsible for delaying the release of CDBG funds to Mississippi.

FY 2006 Supplemental Appropriations Acts: Waivers, Restrictions, and Other Requirements

The two FY 2006 emergency supplemental appropriations acts, which together provide $16.7 billion in CDBG funds to be allocated among the states of Alabama, Florida, Louisiana, Mississippi, and Texas, provide the Secretary of HUD with broad waiver authorities, including waiving the centerpiece LMI test. However, Congress did impose some terms and conditions on the waivers and the use of CDBG funds that apply to the Secretary and the states, including:

1. The Secretary may waive or specify alternative requirements for any provision of any statute or regulation that the Secretary administers in connection with the obligation of CDBG funds, including the LMI requirement, if
2. The Secretary publishes in the Federal Register such waiver of any provision or statute five days before the effective date of the waiver.
3. The Secretary must notify the Committees on Appropriations of any proposed allocation of any funds and related waivers made pursuant to the provisions of the emergency appropriations acts at least five days prior to making such determinations.268
5. In making CDBG allocations pursuant to P.L. 109-148, the Secretary may not allocate more than 54 percent of the funds to any one state.
6. In making CDBG allocations pursuant to P.L. 109-234, the Secretary may not allocate more than $4.2 billion to any one state.

266 Source: CIPP researchers’ conversation with U.S. Department of Housing and Urban Development Office of General Counsel staff (September 22, 2006).
267 Ibid.
268 No language exists in PL 109-148 or PL 109-234 which provides the Congress with any authority to block, modify, or delay the Secretary’s determinations.
The following diagram (see next page) illustrates the processes involved in allocating CDBG funds to an eligible utility in Mississippi, starting with passage of the emergency supplementals by Congress. The diagram shows the interaction of CDBG funding processes with securitization processes in the Mississippi context, with federal agencies such as HUD, the governor, State agencies such as the Mississippi Development Authority (MDA), the Public Service Commission (PSC), and the State Bond Commission (SBC) each having a voice and role in determining exactly how the State’s two electric IOUs will recover Hurricane Katrina costs. (Gas utilities will get no cost recovery from storm bonds.)

This document represents a preliminary assessment based upon publicly-available sources of data and information for ongoing storm cost recovery processes in selected Gulf Coast states. The views expressed herein are those of the authors and may not represent those of the institution.

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Interplay of Securitization and CDBG: Nine Steps

1. Congress appropriates CDBG funds via supplementals, which are signed into law.
2. HUD allocates the funds among the States according to statutory limitations imposed by Congress in the supplementals, other statutes, and CDBG regulations.
3. The governor designates agencies which will develop and administer the State Action Plans. In the case of Mississippi, the governor designated the Mississippi Development Authority (MDA) to develop the State’s plan. State Action Plans are negotiated with HUD, with the state PSC advising the MDA on matters specific to its jurisdictional entities that may be eligible for CDBG money.
4. HUD approves a state action plan, e.g., Mississippi’s Ratepayer Mitigation Plan (RMP).
5. HUD provides statutorily required notices to the Committees on Appropriation and in the Federal Register at least 5 days before funds can be released.
6. HUD releases CDBG funds to the MDA in accordance with the approved Action Plan.
7. The MDA releases CDBG funds to eligible entities and in accordance with state laws and regulatory activities.
8. The utility returns to the PSC after receiving CDBG money.
9. The PSC may (or may not) direct the State Bond Commission to issue bundled storm recovery bonds if there is a shortfall in the amount of CDBG money received and Commission approved storm cost recoveries. Alternatively, the PSC might adopt other solutions to remedy the expected shortfalls, such as non-securitized surcharges and/or accounting treatments.

According to sources at the MDA and the Commission staff, the CDBG process in Mississippi with regard to the Ratepayer Mitigation Plan (RMP) is presently between steps 4 and 5 of the steps listed in the “Interplay of Securitization and CDBG: Nine Steps”. The PSC has scheduled a hearing for October 3, 2006 and on the agenda are the Mississippi Power and Entergy Mississippi securitization dockets. Both MDA and Commission staff consider the release of CDBG funds to be foregone conclusion, with only the date the funds are released unclear. However, CIPP researchers discovered that an unresolved controversy may exist on how the funds are allocated to utilities, especially whether Mississippi’s two natural gas IOUs will receive allocations or whether the $360 million is to be used solely by the State’s two electric IOUs.269

Other issues may arise when implementing the RMP as approved by HUD. To explain these, the following excerpt from Mississippi’s HUD-approved RMP is provided:

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269 Source: CIPP researchers’ conversation with staff of the Mississippi Development Authority (September 22, 2006).

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1). Ratepayer Mitigation

Hurricane Katrina inflicted widespread destruction upon the energy utility infrastructure, resulting in extensive disruptions in service to business and residential communities throughout Mississippi. The utility companies responded rapidly in the aftermath of the disaster to restore services to all impacted customers. The costs to deliver emergency and temporary services and to rebuild damaged infrastructure for permanent service delivery have been considerable. At present, these costs are being carried by the affected utility companies to the extent not covered by their insurance providers. Ultimately, as required by Mississippi law, the prudently incurred costs to deliver emergency and temporary services and to rebuild damaged infrastructure for permanent services, in excess of insurance proceeds, after being approved by the Mississippi Public Service Commission for jurisdictional utility companies, will be passed through to the jurisdictional ratepayers.

Mississippians throughout the State and particularly in the Gulf Coast Region have experienced significant losses as a result of the impact of Hurricane Katrina, including financial losses. To defray passing all the costs of preparing for and performing utility repairs and restoration related to Hurricane Katrina on to its citizens who have already suffered significant loss, the State seeks to mitigate those costs and the ultimate charge to the ratepayers.

The objective of the Ratepayer Mitigation Plan is to protect business and residential customers from bearing the entire cost of the utility infrastructure restoration and rebuilding. $360 million in funds will be allocated through this program and will offset emergency response, restoration and rebuilding costs incurred by the utility companies that would otherwise be passed through to the ratepayers. Such costs are those prudently incurred by the utility companies after they have diligently and aggressively pursued all insurance recoveries within the terms and conditions of the applicable insurance policies covering their losses and after these costs are certified as provided for herein. By State law, costs which are reimbursed under the Ratepayer Mitigation Plan, cannot also be included in a rate increase to consumers.

Program Eligibility

Eligible applicants for this program are limited to electric and gas utility companies certificated by the Mississippi Public Service Commission and with service territory in the affected area in the State that incurred costs resulting from Hurricane Katrina. Prudently incurred costs, as required by Mississippi law, and as approved by the Public Service Commission for jurisdictional utility companies, will be passed through to the jurisdictional ratepayers. Such costs include those charges allocated to wholesale customers (including Electric Power Associations) of Mississippi Power Company (“MPC”) as their share of the eligible costs of restoration. These wholesale customers are eligible for an allocation of funds to defray their share of these costs in an amount not to exceed $10 million in total. The allocation of the cost of restoration determined by MDA for this purpose will be included in the total allocation of CDBG funds to MPC for credit against charges allocated to the respective wholesale customers. The CDBG funds may only be used for restoration and recovery, not foregone revenues.

Eligible Costs

Eligible utility companies may submit a request for reimbursement of eligible costs which include costs for: (1) preparing for and providing emergency and temporary service response and permanent restoration of utility service to Mississippi businesses and residents who experienced outages as a result of Hurricane Katrina and (2) service interference and the rebuilding and improvements of utility infrastructure in the wake of Hurricane Katrina. Lost
revenues and business interruption losses are not eligible costs under this plan. Additionally, costs that would have been incurred as part of normal operations are not eligible.

With respect to claims for costs of damages sustained as a result of Hurricane Katrina, the reimbursement of costs covered under any applicable insurance policy shall be primary to any consideration for receipt of funding through this Partial Action Plan. As such, coverage under all applicable insurance policies shall pay first, or be subrogated back to the State, in the event that coverage was in place. Any un-reimbursed eligible costs that remain after receipt of all applicable insurance recoveries may be submitted for consideration under this Plan.

In the event that eligible costs exceed the allocated funds of $360 million, or additional amounts as may be allocated, there will be a proportional allocation to the applicants based upon their certified costs.

**Review and Approval of Eligible Costs**

The Mississippi Public Service Commission is the state agency that analyzes, certifies, and approves all jurisdictional utility company costs and rates. Under this program, costs for which a utility company is seeking ratepayer mitigation must be submitted to the Commission and the Mississippi Public Utilities Staff, who will follow their normal processes and methodologies for analyzing, auditing, validating, and certifying costs to determine eligibility under the Ratepayer Mitigation Plan. Utility companies are required under Mississippi statutory law to allow the Mississippi Public Utilities Staff access to the financial books and records of the company as needed, in order to ensure confirmation of expenditures claimed for ratepayer mitigation. Such access must also be extended to federal officials in accordance with administration of the federal funds for this program. Utility companies seeking reimbursement must disclose all related insurance coverage and the status of pending and settled claims. The Mississippi Public Utilities Staff, after analyzing and auditing the pertinent records, will submit a recommendation to the Mississippi Public Service Commission, which will then provide to MDA an Order determining and certifying the total un-reimbursed costs eligible for ratepayer mitigation. Based on this Order and information, MDA will determine the amount of ratepayer mitigation for each applicant as provided hereinabove.

As noted previously, federal CDBG eligibility guidelines specifically refer to “privately owned utilities,” but confined to “distribution lines and facilities”. The PSC’s order for MPCO and EMSI include items that arguably are outside distribution, and the RMP makes no distinction between distribution, generation, and transmission. Further, the RMP specifically states that utilities must provide the same level of access to its financial books and records “to federal officials in accordance with administration of the federal funds” for RMP. Who will these federal officials be? Will they have experience and expertise in accounting, corporate finance, and the electric power industry? What happens in the event of a disagreement between state regulators and federal officials on cost recovery using CDBGs? Will federal officials be in the position of second-guessing commissions and other state officials? What issues arise with regard to data sharing and security protocols when federal officials have access to utilities’ financial books and records? Will
such information be protected against public disclosure? Will such data and information be available to federal officials outside HUD, including officials at agencies with regulatory authority over these utilities?

CIPP researchers have assessed Congressional Research Service (CRS), Government Accountability Office (GAO), and Office of Management and Budget (OMB) reports, testimony, and audits of HUD’s CDBG program. Notwithstanding the quite different missions, staffing, and cultures at these three government entities, all three have similar criticisms of HUD’s CDBG program. CIPP’s July 2006 internal working paper, *Community Development Block Grants: Funding the Restoration and Reconstruction of Critical Infrastructure*, provides several references critical of past CDBG disaster-related infrastructure efforts, notably from the CRS, the Public Utility Law Project of New York, and research by an economics professor at California State University-Fullerton.272 On OMB’s ExpectMore.gov website, the agency’s assessment of the CDBG program reports it is “not performing/ineffective”.273

On August 28, 2006, the GAO publicly released *Community Development Block Grants: Program Offers Recipients Flexibility but Oversight Can Be Improved*.274 CIPP researchers interviewed several members of the GAO team who conducted the investigation and authored the report, and confirmed that this GAO report is not an analysis of the hurricane emergency FY 2006 supplemental appropriations acts that provided an additional $16.7 billion in CDBG funds. Rather, the GAO report investigates and analyzes the “normal” annual CDBG process. The report is very useful to this research project, however, because it points to a number of issues that, under the processes of the supplementals, will provide even less transparency and accountability. Some key findings of this report, extracted almost verbatim, are:

- CDBG recipients spend the largest percentage of grants on public improvements such as municipal water lines and streets. However, GAO staff note, this does not necessarily provide HUD with critical energy infrastructure expertise or experience.
- HUD does not centrally maintain the data needed to determine CDBG program compliance. The data system HUD has, known as the Integrated Disbursement and Information System or IDIS, is neither integrated nor user-friendly; HUD workers in the Department’s 42 field offices do not use the system or use it improperly. A contractor has been hired to re-vamp IDIS but completion dates are repeatedly extended and the project is HUD-Headquarters driven; those in the field offices are not being directly consulted on changes to the system.

272 See Appendix. [This document briefly explains issues regarding the appropriateness, accountability, overall coordination, and effectiveness of federal disaster and emergency assistance provided via Community Development Block Grants and the Stafford Act to state and local governments, the private sector, and other entities for the restoration and reconstruction of critical infrastructure. The early winter 1998 New England ice storms and 2001 terrorist attacks on the World Trade Center are referenced.]
274 GAO-06-732. [The report was issued in July 2006 to subcommittees of the House Financial Services Committee, the House Government Reform Committee, and the Senate Committee on Homeland Security and Governmental Affairs.]
• GAO staff believe that the emergency supplements may not be tracked by IDIS. GAO staff have heard, mostly through “anecdotal reports in the trade press”, that HUD may be trying to set up a system separate from IDIS.

• Of HUD’s 42 field offices, 13 offices – nearly one out of every three field offices – do not have a financial specialist on staff to evaluate how CDBG funds are being used. Thirty-nine percent of CDBG monitoring staff will be eligible to retire over the next three years, but this graying workforce issue is not being addressed. (GAO staff declined to identify the 13 offices and would not comment on field offices in the Gulf Coast states.)

• Even in the normal CDBG appropriations and entitlement grant processes, HUD has not developed consistent policy and clear guidance. The result, GAO found, is very inconsistent accountability and imposition of sanctions.

CIPP researchers and GAO staff discussed other issues not specifically in the GAO’s August 28, 2006 report, including the nexus of Stafford Act authorities and funding under CDBG authorities. A unit within GAO is involved in forensic investigations to uncover fraud, primarily from duplication of payments since current IDIS data is poor and there lacks a simple way to cross-tab disbursements and expenditures among Stafford Act (primarily US Department of Homeland Security/Federal Emergency Management Agency), HUD, and Small Business Administration sources.

Given past and current problems with the CDBG program with regard to IOU infrastructure reconstruction, it is reasonable to question whether community block grants administered by HUD are an appropriate and effective policy instrument in providing infrastructure assistance for purposes other than HUD’s traditional housing and community development charter. The amount of CDBG funding is uneven among the states because of “supplemental politics”, an issue that caused the 1998 ice storm funding to unravel, inconsistent state approaches to the use funds – with states such as Florida apparently foregoing any provision of block grants to IOUs, and the protracted matter of actual disbursement of money. The introduction of CDBGs has – in at least two states – delayed PSC closure on utility cost recovery dockets. There is very little federal-state coordination, and what does occur is on a state-by-state basis although infrastructure being recovered may span a multi-state region. In one case, the availability of CDBG funds has even become an issue in a utility filing a reorganization plan in federal bankruptcy court. This section concludes with a recitation of some of the questions raised during CIPP researcher discussions of CDBGs:

• Is the Community Development Block Grant program an appropriate and effective means of providing federal support for long-term disaster recovery and resilience? If it is, how should funding allocation decisions be made? If not, what other policy options to CDBGs exist?
• Who should make decisions regarding CDBGs in a major disaster spanning multiple jurisdictions: individual communities, states, or multi-state regional entities? Is a more involved federal coordinating role suggested?

• Who will make infrastructure decisions for the use of CDBG funds? Will they have sufficient knowledge of critical energy infrastructure? In particular, what are the possible ramifications of providing federal officials with full access to utilities’ financial books and records as is required in Mississippi?

• How should the Stafford Act and block grant responses be integrated with the National Response Plan and, in particular, its Long-Term Community Recovery and Mitigation Annex? How should they be integrated with the Emergency Support Functions of various federal agencies?

• What additional accountability and compliance measures should Congress consider from those who administer and receive CDBG disaster and emergency funds?

Conclusions and Issues for Further Consideration

All four Gulf Coast states examined for this report have made securitization one of the options that can be used to pay for unprecedented infrastructure costs that have overwhelmed traditional mechanisms and reserve funds. At least two of these states also intend to use what appears to be a very small percentage of their overall allocations of CDBG funds to pay some of the IOUs’ infrastructure recovery costs. Proponents of each of these policy instruments have made a number of arguments in their favor, several of which are summarized below. Less visible in the current environment are concerns about widespread use of securitization by state commissions and electric utilities, and precedents that may be established by a provision of CDBG funds to IOUs that may impose daunting demands on federal taxpayers in the aftermath of future catastrophes; several such concerns also are represented below.

The most frequently mentioned benefits of securitization are that utilities receive a more immediate infusion of cash to pay for storm restoration costs and that the “rate shock” to customers is minimized when compared to “traditional” methods. Securitization insulates the utility from the issuance of debt for which its customers are the debtors; this preserves the utility’s credit position. AAA-rated bonds provide investors with security and ratepayers with “least cost” financing, thus lowering the amount each customer class will pay. Given the data and information currently available, these benefits seem to be true. On the other hand, independent ratings agencies and other experts caution that securitization can be overdone – it is not a panacea for each and every utility cost recovery docket. Ellen Lapson of Fitch Ratings, for example, suggests that any given securitized bond issue should be less than 20 percent of the total utility bill and preferably...
much less. She and other experts advise against using securitization to pay for fuel costs, retiring profit-earning assets, or to finance a “permanent layer of utility capital structure”.

Speaking at the National Association of Regulatory Utility Commissioners’ (NARUC) 2006 Winter Committee Meetings, former Michigan Commissioner and NARUC President David Svanda offered an old story with a contemporary securitization analogy illustrating how the use of UTBs can be helpful or harmful depending on the circumstances. Mr. Svanda begins by recounting a young reporter’s attempt during the days of Prohibition to pin down a sage politician by asking his views on consumption of alcohol, to which the voice of political experience, if not expedience, replied that he could be all for it or dead set against it; whether alcohol is the “spirit that liberates our souls” or “that vile substance” all depends on perception, implementation, and outcome. To paraphrase Mr. Svanda’s analogy as to whether securitization can be seen as a “good” or “bad” policy tool – or somewhere in between, the three tests of perception, implementation, and outcome can be applied. Securitization probably will withstand the test of time when it reduces regulatory uncertainty, when it encourages badly-needed investments in electric power infrastructure to improve reliability or to harden systems, when it is used to pay for high-cost environmental remediation projects or reconstruction caused by catastrophic events, and when it provides market-based “least cost” debt financing that protects investors.

Over the longer term, securitization may fail if it is repeatedly used for the kinds of costs incurred today that reasonably could and should be paid for today, such as fuel costs, if it mortgages ratepayers for generations, is used to pay for profit-making assets, thus removing them from the earnings ledger, or if the cumulative total costs of securitizations exceed what independent ratings firms will tolerate to provide the AAA rating. CIPP researchers often posed hypothetical “what ifs” to commission staff, such as “the financing order pays for the costs of year 2005 hurricanes over 12 years. What if securitization continues to be used for the next year’s storms, the next, and the next?” The likelihood that the Gulf Coast states will escape one if not several costly disasters over the proposed life of today’s storm recovery bonds seems remote.

Use of CDBGs for IOUs’ storm recovery costs raises the some of the same kind of paradoxes, for which there is no “right” answer at this time. For example, when a regional catastrophe overwhelms the abilities of state emergency officials and IOUs to quickly and comprehensibly restore electricity without further sending ratepayers into a tailspin and thus retarding economic recovery and growth, then a limited use of CDBG money may be a “good thing”. If, however, commissions, utilities, and customers develop a dependency on federal grants to avoid making tough but necessary decisions about continued development in harm’s way, and to avoid planning and paying for future needs of a hardened, more resilient electric power infrastructure, then the use of CDBG funds may come to be viewed as something “bad”. The determination

275 Lapson, Utility Tariff Bonds, 7.
of “good” or “bad” all depends on how federal money actually is delivered, used, and is accounted for. Implementation, accountability, and outcomes do matter, and not just presently in the Gulf Coast states.

When, in FY 1998, Congress made the first emergency supplemental appropriation that permitted impacted states to tap CDBG funds for IOU recovery costs, a caution was raised by House and Senate managers that warrants repeating today:

The Conference have serious misgivings about providing CDBG funds for disaster mitigation [which differs from restoration], particularly given the waiver authority and the possibility that the majority of funds will be spent to cover the repair costs of investor-owned utility companies.276

In 2002, Congress again appropriated CDBG funds to pay for Con Edison’s recovery costs as the result of the 9/11 attacks. However, the Public Utility Law Project of New York recently stated that “[t]he question of who will pay for the utility recovery costs of the 2001 World Trade Center attack remains unresolved in 2006.”277 Robert J. Michaels, a professor of economics at California State University-Fullerton points to a knowledge void in which CIPP concurs: “[t]here is a near total lack of research on how regulators should monitor utilities’ disaster recoveries and the proper scope of this [CDBG] activity.”278

CIPP research to-date suggests that a legal twilight zone exists between Stafford Act emergency response authorities and long-term restoration after the lights are on again, which at this time seem to be addressed ad hoc. From the limited record, it is not clear that CDBGs, funded in the emotional and political contexts of national disasters and emergency supplemenitals, are the appropriate instrument to fill current statutory and administrative voids. This is an area that is ripe for future research and analysis.

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276 See Congressional Record – House, p. H2644 (April 30, 1998). The conferes appropriated $130 million for CDBG funding activities for all presidentially-declared natural disasters occurring during the entire fiscal year of 1998, which at the time the supplemental was enacted into law had not yet ended. Much of the debate over this 1998 precedent occurred in the Senate, where Senators Stevens (R-Alaska, then Chairman of the Appropriations Committee), Bond (R-Missouri, then Chairman of the subcommittee with jurisdiction over FEMA), Nickles (R-Okalahoma, considered by many to be a “fiscal hawk”) and Mikulski (D-Maryland) engaged in a lively debate on March 25, 1998. See Congressional Record – Senate, pp. S2535 – S2541 (March 25, 1998).


Addendum

Last Updated October 30, 2006, 1:00 PM Eastern Standard Time

to


DOE Grant DE-FG26-04NT42250

“Energy and Measures for Risk Mitigation and Transfer”

This document was compiled by staff of the Critical Infrastructure Protection Program (CIP Program) during the week of October 23 – 29, 2006. In addition to public sources, CIP Program researchers conducted additional telephone interviews with staff members of the Florida and Mississippi Public Service Commissions (PSCs).

Florida

Owing to market sensitivities, staff could not comment on the timing of the sale of storm bonds authorized by the only securitization financing order approved by the Commission to date as a result of catastrophic storms that made landfall in the State during 2004 and 2005. Based upon previous discussions regarding the completion of pre-sale AAA ratings by all three major independent ratings firms and what the staff could not say, we expect the sale of the bonds amounting to approximately $708 million plus financing costs to occur any day now. Staff noted that the Commission retains final approval over the sale of the bonds which, in the determination of the Commission, must achieve “least cost financing” for ratepayers. The Special Purpose Entity that Florida Power & Light (FPL) will establish pursuant to the financing order and statute must provide the Commission with three days advance notice prior to the intended date of sale; during this three day window, the Commission may reject the offering and remand the matter back to rehearing. This is not expected, however, given the excellent pre-sale ratings.

Staff remarked that the Infrastructure Hardening Initiative (IHI) is picking up momentum with the expectation that the project will be entering the rulemaking phase in three weeks (probably at the November
21, 2006 meeting). All of the State’s electric investor-owned utilities (IOUs) have given proposals to the Commission. The Commission already has issued a pole inspection order and is examining other IHI issues—an example of which is an interoperable information system for tracking the IOUs’ infrastructure assets before and after a storm. More stringent vegetation management (VM) practices are also a component of the IHI. The Commission proposed a three-year cycle for VM programs for all PSC-jurisdictionable circuits. The Commission has received VM program cost analyses from the IOUs for three, five, and six-year cycles which have been approved on an interim basis. Staff noted that the interim ruling for FPL’s six-year cycle VM program “caused a bit of a ruckus in the press” and resulted in a protest being filed by consumer advocates and thus the certainty of public hearings. Although FPL gained interim approval for a six-year cycle that is estimated to be less costly than more frequent VM plans, the utility’s plan and the Commission’s interim ruling are being criticized by consumers on seemingly conflicting complaints that the plan will be too costly for ratepayers and is not rigorous enough.

At the November 21, 2006 meeting, the Commission may require electric IOUs to file three-year VM plans within 90 days. The Commission will require the IOUs to provide a detailed costing of the plans. Major regulatory challenges loom in determining “where, when, and how” to require implementation and to address questions of “who pays”.

Other IHI activities noted by staff are:

- Windspeed measurement studies are being conducted by the University of Florida using new technology and methods.
- Development of a request for proposal (RFP) for an outside consultant to perform an undergrounding case study, the first phase of which is a literature review.
- Higher construction and engineering standards – IOUs are embracing this initiative, but staff reported the Commission is encountering “a long stall” from cable, telecommunications, and other third-party attachers who object to paying a portion of the IOUs’ costs.

Staff also confirmed that, prior to the onset of the 2005 hurricane season, a [still unnamed] insurance company was offering Florida IOUs the same type of $50 million, five-year transmission and distribution (T&D) storm insurance policy “with lots of restrictions” that was reported to us by sources in Mississippi earlier in our research. As was the case in Mississippi, Florida IOUs did not purchase the insurance due to high cost, extremely limited coverage, and uncertainty about how the Commission might allocate the costs of insurance. Staff were interested in CIP Program research on insurance and noted that regulations developed by the Commission after Hurricane Andrew require IOUs to report annually to the Commission on insurance availability.

The staff made suggestions for improving federal-state coordination in response to disasters; these will be discussed during the presentation.
Louisiana

CIP Program researchers attempted to speak directly to staff at the State’s PSC, but as of this writing have not been able to conduct an additional interview. Since the CIP Program formally transmitted its research deliverables to DOE and NETL, the following developments have occurred in Louisiana:

- Governor Blanco made a decision to allocate the entire $200 million allocated for IOUs in one of the State’s Community Development Block Grant (CDBG) applications to a single utility: Entergy New Orleans (ENOI).
- Subsequently, the Louisiana Recovery Authority (LRA) passed a resolution endorsing allocation of $200 million to ENOI to pay for a portion of its sought storm restoration costs. The LRA resolution, which does not provide certainty that HUD will actually approve CDBG funds for this purpose, does provide answers to how the money, if approved, will be used and accounted. Specifically, the LRA resolution states that the utility cannot count operation and maintenance (O&M) and infrastructure paid for with CDBG money in its rate base. The resolution also seems to weaken the New Orleans City Council’s regulatory jurisdiction over ENOI and other utilities. In addition to requiring approval from HUD, the Louisiana legislature also must approve the $200 million allocation unless the Governor revises action plan requirements. The LRA resolution is included with the slide show presentation documents.
- The Associated Press (AP) reported that on October 27, 2006, the New Orleans City Council approved an agreement with ENOI on electric and gas rate increases due to the 2005 hurricanes. Since the City Council does not post decisions on the Internet, a copy of the AP article is included with presentation documents. As reported by the AP, the agreement includes a rate freeze on the electric side of ENOI until January 2008, but a phase-in of rate increases for gas starting next month (November 2006) that are expected to top out at $12 per month for the average residential customer. Once the electric rate freeze expires, electricity rates are estimated to increase 2.5 percent per month and “the average gas and electric customer will see a total increase of about $15 per month, or 8.2 percent, over October 2006’s average electric and gas bill of $182.10.” Starting November 2006, ENOI is authorized to start collecting $2.56 per month from the average residential customer to pay into a $75 million storm reserve fund. Adding to overall electricity cost increases is a fuel adjustment charge for Grand Gulf Nuclear Power Station that puts an additional $20 on the average ENOI ratepayer. The City Council–ENOI agreement apparently removes Grand Gulf from ENOI’s operating cost, but base rates remain unchanged at a reported $50.58 because there are far fewer customers in New Orleans.
- While Governor Blanco has publicly stated that the $200 million in federal CDBG money is the end of the road for use of these funds by ENOI and any other Louisiana IOU, CIP Program researchers expect that neither this agreement nor related cost recovery actions by the State’s PSC will end attempts by utilities and State officials to obtain more federal money to pay energy utility storm restoration costs and mitigate the impact on ratepayers. Higher energy costs are viewed as a serious impediment to economic recovery and
attracting new and former customers to New Orleans. The temporary electric rate freeze may allow City and State officials time to obtain additional federal assistance.

- Last week, ENOI filed its bankruptcy reorganization plan with the federal bankruptcy court. Consistent with the LRA resolution, the plan does not propose to use any of the requested $200 CDBG money to pay creditors.

Mississippi

On October 24, 2006, the US Department of Housing and Urban Development (HUD) published a notice in the Federal Register (vol. 71, no. 205) entitled “Additional Waivers Granted to and Alternative Requirements for the State of Mississippi under Public Law 109-148”. Public Law 109-148 (December 30, 2005), which is discussed in CIP Program research deliverables, is the first of two FY 2006 emergency supplemental appropriations acts passed by the Congress. Among other things, the Act provides $11.5 billion in CDBGs that, inter alia, may be used by “privately-owned utilities” to pay for certain disaster-related restoration and long-term recovery activities (see 24 CFR Part 570). The effective date of the HUD waivers is October 30, 2006. The waivers were required in order for Mississippi to implement facets of its State Action Plan, which HUD approved in principle last summer.

- This Federal Register notice provides several examples of the complexities HUD must consider before approving state requests to use federal CDBG money to pay for certain disaster-related costs, such as private utilities uninsured service restoration costs and reinsurance. As CIP Program researchers have noted, Mississippi seeks to use $360 million in CDBG funds for its Ratepayer Mitigation Plan, which is to be allocated among the State’s two electric power and two gas utilities. The State also seeks to use CDBG funds for its Wind Pool Reinsurance Plan maintained by the Mississippi Windstorm Underwriting Association (MWUA).

The Secretary of HUD is required by the underlying Housing and Community Development Act of 1974 (also known as the Cranston – Gonzalez National Affordable Housing Act, as amended) and PL 109-148 to make a finding that the intended purpose of CDBG funds is “not inconsistent” with the program’s primary purpose which is found at 42 USC 5301(c). To decrease or eliminate the difficult “Low-Moderate Income” requirements below the 50 percent requirement, the Secretary must also make a finding of “compelling need” for the waiver. In the past, as CIP Program researchers have noted, this has been very difficult and contentious with regard to utilities. We quote sections of HUD’s 24 October 2006 Federal Register notice to illustrate this point:

The secretaries of HUD have granted very few overall benefit waivers for past disaster recoveries... HUD also allowed the State of Maine, following severe ice storms, an overall benefit waiver that permitted the state to use its entire grant to assist private utilities with uninsured service restoration costs. Logically, a utility grid or service area cannot be restored for one income group alone, and this type of disaster affects everyone in an area, regardless of income. There was no practical methodology in this example for allocating costs among income groups.
The case of Mississippi is more complicated than those in Maine and Grand Forks because of the large number of political sub-jurisdictions, choice of possible activities, the effects of the mix of activities, population movement, and the catastrophic scale of the disaster. As in Maine, whole areas of Mississippi were impacted regardless of income (and far more severely in Mississippi than in Maine), so many of the state’s proposed activities are area- or sector-wide. As in Grand Forks, the majority of Mississippians in the most impacted areas were not income-eligible prior to the storm so the state’s recovery strategy must necessarily address the needs of a range of income groups.

Mississippi has a much larger CDBG grant than either Maine or Grand Forks.

HUD also considered the other CDBG disaster recovery activities the state is undertaking. After the June 14 waiver, the state made Action Plan amendments including some additional CDBG disaster recovery activities that do not qualify under the low- and moderate-income national objective, such as assistance to private utilities, wind pool reinsurance, and regional infrastructure development. . . . HUD considered the data and the state’s justification for its request. Considering that the state has not yet budgeted all of its grant funds in the Action Plan . . . HUD decided that the department does not have enough information to conclude that the state has a compelling need for a waiver of overall benefit for the entire grant at this time.

Based upon the compelling need for the activities already included in the Action Plan for Disaster Recovery for the grant made under Public Law 109-148, HUD is granting the state a waiver of the requirement that at least 50 percent of the supplemental CDBG grant funds provided under Public Law 109-148 primarily benefit persons of low and moderate income, to the extent necessary to permit Mississippi to carry out the activities contained in its March 31, June 28 and July 12, 2006 Action Plan submissions. . . .

Since the Ratepayer Mitigation Plan was included among the activities contained in the above-mentioned action plans and specifically detailed in the June 28 and July 12, 2006 Action Plan submissions, CIP Program researchers tentatively conclude that this Federal Register notice will trigger the release of CDBG funds to Mississippi energy utilities. We note, however, that the Ratepayer Mitigation Plan is not mentioned specifically in the HUD notice, whereas the Wind Pool Reinsurance Plan is discussed frequently by name. (Our sources at the Mississippi Development Administration were not in their offices when CIP Program researchers called seeking clarification.)

On October 25, 2006, CIP Program researchers spoke with the Executive Director of the Mississippi Public Utilities Staff, who indicated at that time it was the intention of the PSC to issue final securitization financing orders on or before October 27, 2006 regardless of whether federal CDBG funds were in hand for the Ratepayer Mitigation Plan and allocated to the State’s electric utilities. On October 30, 2006, CIP Program researchers received a call from a senior attorney in the General Counsel’s office at the US Department of Housing and Urban Development (HUD), who provided confirmation that Mississippi’s Ratepayer Mitigation Plan, while not specifically mentioned by its name, was subject to waivers provided by HUD. These waivers enter into force on Monday, October 30, 2006 and will thus allow federal CDBG funds to flow from the federal government to the MDA and then to the state’s four electric and gas utilities.
Texas

Due to this State's requirements under its storm cost recovery securitization statute, at this time the State is continuing to “count down the clock”; no new developments have occurred. Notably, like Florida, the Texas Public Utilities Commission has an infrastructure hardening initiative.
Utilities hold the cards in storm rebuilding

NEW ORLEANS (The Associated Press) - Oct 29 - By ALAN SAYRE Associated Press Writer

Like it or not, a delayed hurricane-strength gust will soon blow into mailboxes across Louisiana, carrying higher utility bills resulting from last year's storm damage to power and natural gas systems.

Investor-owned utilities are pursuing their legal right to recover from customers uninsured, storm damage costs. The strategy is favored by the law, regulatory rulings and court decisions, and ratepayers will end up footing the bill unless some government or corporate largesse appears.

What has to be covered is the cost of storm damage to utility systems, less insurance payments and - only in the case of one provider, so far - the possibility of federal relief funds.

Customers of the Entergy Corp. units - Entergy New Orleans, Entergy Louisiana, Entergy Gulf States - and Cleco Corp. are stuck with the difference. All customers in Louisiana would be affected, not just those that were in the path of hurricanes Katrina and Rita. That means consumers will be feeling the effect in places such as Farmerville, in Union Parish, and Homer, in Claiborne Parish - hundreds of miles from the coast.

In more normal times, utility companies with service monopolies would get a regulatory-granted rate of return on operations. If the rate got too high, customers got refunds. If the rate got too low, rates went up. But it gets real expensive if a storm tears apart an investor-owned utility system.

The situation is particularly galling to many in this city, where bankrupt Entergy New Orleans wants to add about 50 percent more to power and gas bills to pay for storm damage, even if the state Legislative and federal officials approve $200 million in aid. ENO's parent, Entergy Corp., recently forecast a strong third quarter, and its stock hit a 52-week high.

But Entergy New Orleans is only a tiny part of the parent company, which chalks up its recent, good corporate fortune to Entergy Nuclear, an unregulated unit that owns and operates nuclear power plants in the South and Northeast. ENO, which currently has only about 80,000 customers, is a drop in the bucket compared with Entergy Gulf States and Entergy Louisiana, which, together, have 1 million customers in the state.

Some have suggested that since the Entergy parent is doing so well, it would be nice if the corporate coffers helped cover the damage. Public Service Commission member Foster Campbell said Entergy has a "moral obligation" to cover its uninsured damage without federal help or customer charges. The potential economic burden is too much for customers to bear and will stifle recovery, Campbell said.

But another PSC member, Jay Blossman, said changing the rules now could have unforeseen circumstances. Blossman said that, too often, the public views the owners of a company only in terms of its employees and top officials.

"People all over the world own Entergy stock, not just the people who work there," Blossman said. "If you change the rules in midstream, you are not only dinging the employees, but a little old school teacher from Minnesota could be in trouble."

Blossman also said Entergy's whole world doesn't consist of guarantees: If unregulated Entergy Nuclear fell on hard times, the parent company could not come to its regulated utility customers to make up the difference.
Gov. Kathleen Blanco, who pushed the Louisiana Recovery Authority to recommend the $200 million grant to Entergy New Orleans, warned that without government help, consumers will bear the full brunt of paying for the uncovered storm damage.

"They will win in court every day," said Blanco, a former PSC member.

Louisiana State University economist Loren Scott said the state, and especially New Orleans, is in a tight spot: Recovery can't happen without utilities, but skyrocketing rates will stifle the recovery.

"My guess is this is going to energize the political sector to find some more money from the federal coffers," Scott said.

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New Orleans' electric woes eased slightly under plan

NEW ORLEANS (The Associated Press) - Oct 27

The City Council approved an agreement with Entergy New Orleans on Friday that will keep electric and gas rates from rising dramatically in the next year, a move that city officials hope will help the rebuilding.

Under the agreement, electric rates would be frozen until January 2008 and gas customers would see gradual rate increases reaching about $12 a month by November 2007. Entergy New Orleans also will begin collecting $2.59 a month per customer in March to build up a $75 million storm reserve fund, according to Clint Vince, the city's lead negotiator in the agreement.

By 2008, the average gas and electric customer will see a total increase of about $15 per month, or 8.2 percent, over October's average electric and gas bill of $181.10.

The agreement allows for an additional 2.5 percent increase in electric rates in January 2008.

In July, Entergy New Orleans filed a request to raise rates 25 percent, or about $45 per month per average customer, including collecting money to pay off its storm damages and build up a $150 million storm reserve fund.

Entergy New Orleans had warned after the storm that its customers could see rate increases as large as 140 percent if it didn't receive more than $700 million in federal money it requested. Earlier this month, it received approval for $200 million in federal funds. That $200 million directly offsets $10 of the rate increase that Entergy was requesting, Vince said.

The City Council has been arguing for minimal or no rate increases, saying that dramatic increases would damage the city's ability to recover from Hurricane Katrina.

Council President Oliver Thomas called the agreement a "home run."

Dan Packer, president and CEO of Entergy New Orleans, said the plan "puts the company on more solid footing."
The company this week filed a plan to reorganize and emerge from bankruptcy by the end of next year. It said a rate increase, the $200 million in federal funds and obtaining $250 million in insurance payments are critical for the company to get out of bankruptcy.

Meanwhile, customers are still getting hit with hefty bills because of a de-facto recent increase of about $20 a month because they are paying for the costs of Grand Gulf nuclear plant in the fuel adjustment charge. Entergy says the increase in fuel adjustment charges is necessary because it was not collecting enough money from its reduced customer base to cover all of its fixed costs after Hurricane Katrina.

If it weren't allowed to collect the money for Grand Gulf in the fuel adjustment charge, it would have gone further in the red, according to company officials.

The settlement removes Grand Gulf from the company's operating costs, but the base rates remain $50.78 because there are fewer customers in New Orleans to pay those total fixed costs.

But if more customers return to New Orleans, that $20 a month charge could be reduced as the charge is spread out over more customers.

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24 CFR 570.201 Basic eligible activities.

CDBG funds may be used for the following activities:

…

(l) Privately owned utilities. CDBG funds may be used to acquire, construct, reconstruct, rehabilitate, or install the distribution lines and facilities of privately owned utilities, including the placing underground of new or existing distribution facilities and lines.

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