BEFORE

THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Joint Application of Ohio Edison Company, The Cleveland Electric Illuminating Company, and The Toledo Edison Company for Authority to Issue Phase-In-Recovery Bonds and Impose, Charge and Collect Phase-In-Recovery Charges and For Tariff and Bill Format Approvals	)	Case No. 12–1465–EL–ATS

REPLY COMMENTS OF APPLICANTS, OHIO EDISON COMPANY, THE CLEVELAND ELECTRIC ILLUMINATING COMPANY, AND THE TOLEDO EDISON COMPANY

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Reply Comments of Applicants, Ohio Edison Company, The Cleveland Electric Illuminating Company, and The Toledo Edison Company

Applicants, Ohio Edison Company ("OE"), The Cleveland Electric Illuminating Company ("CEI"), and The Toledo Edison Company ("TE" and together with OE and CEI, the "Companies"), by counsel, in accordance with the Public Utilities Commission of Ohio Entry dated May 25, 2012, hereby submit their Reply Comments in this matter.[1]

I. Introduction

The Companies filed their securitization Application on May 3, 2012. The proposed securitization will benefit customers by providing both cost savings and rate mitigation through the reduction of (i) overall cost of these regulatory assets (i.e. Phase-In Costs) and (ii) the rates customers currently are paying toward their recovery. The securitization transaction also is expected to significantly reduce the carrying charges over the recovery period for these Phase-In Costs resulting in customer savings through the issuance of the Phase-In Recovery Bonds (even

[1] Any capitalized term used but not defined herein shall have the meaning given to such term in the Joint Application of Applicants for Authority to Issue Phase-In-Recovery Bonds and Impose, Charge and Collect Phase-In-Recovery Charges and for Tariff and Bill Format Approvals Change (the "Application").

after including applicable Financing Costs as discussed below). The Phase-In-Recovery Bonds' recovery period will not exceed the overall recovery period under the existing cost recovery methodologies approved by the Commission for such regulatory assets, and will result in estimated costs savings to customers of approximately $104 million in the aggregate, based on market conditions at the time of filing of the Application. In addition, the proposed securitization is expected to mitigate rate impacts to customers by flowing the cost savings through to customers annually in a manner that yields lower associated rates compared to the traditional cost recovery mechanisms previously approved by the Commission.

Both Commission Staff and the Office of the Ohio Consumers' Counsel ("OCC") commented on the Companies' Application.[2] Staff was generally supportive of the Application and raised only a few issues that the Companies will address below in Section II. Although the OCC's comments appear generally critical and at times inapposite, much of this appears to be born out of lack of information or familiarity with particular aspects of a securitization transaction rather than concrete opposition to the Application. The Companies address the more pertinent comments of OCC below in Section III.

II. <u>Staff Comments</u>

The Companies appreciate the time and resources devoted to reviewing the Companies' Application. The Staff Comments include a thoughtful and in-depth review of the proposed securitization transaction reflecting the Staff's knowledge and expertise of securitization transactions and the regulatory ratemaking impacts of such transactions. The Companies' view differs only in a few respects with those of the Staff. First, as detailed in Section II (A) below, a

[2] The only intervening party in this proceeding is OCC.

105% cap is inappropriate for Financing Costs given that increases in debt retirement costs, which represent a significant majority of the total upfront Financing Costs, typically would be expected to at least partially be offset by declines in interest rates on the Phase-In-Recovery Bonds. Second, as detailed in Section II (B) below, the Financing Order needs to contain language related to the potential for third- parties that may bill and/or collect Phase-In-Recovery Charges in order to better ensure that Phase-In-Recovery bonds are of the highest credit quality, which is imperative in order to achieve the customer savings estimated by the Companies in their Application. Lastly, as detailed in Section II (C) below the Companies believe that the issuance standards set forth in and mandated by the Act[3] should be utilized by the Commission, rather than the approach suggested by Staff, and that certain changes should be made regarding the Staff's proposed Issuance Advice Letter.

A. Staff's proposal for a cap on debt retirement costs should not be accepted

The Staff makes a recommendation to the Commission that the Companies seek Commission approval after pricing of the Phase-In-Recovery Bonds occurs if the up-front Financing Costs and/or the ongoing Financing Costs are in excess of 105% of the estimated costs as illustrated in Exhibit C of the Application.[4] Staff makes this recommendation due to their belief that the Financing Costs could substantially impact the savings to customers should the actual costs vary significantly from the estimated costs. However, with respect to the debt retirement portion of upfront Financing Costs, Staff's supposition that increasing Financing Costs could impact customer savings does not necessarily hold true.[5] To the contrary, increasing

[3] Amended Substitute House Bill Number 364; 129th General Assembly.

[4] Staff Comments, p. 26.

[5] The Companies do not believe any cap on Financing Costs is appropriate or contemplated by the Act. In any event, the 105% cap or any cap the Commission should decide to implement should only apply to fees incurred to accomplish the transaction as proposed by the Companies, and should not apply to increased fees arising due to

debt retirement costs may be offset by lower interest rates on the Phase-In-Recovery Bonds, and in that circumstance debt retirement costs should not adversely impact customer savings in any meaningful way.

Debt retirement costs are expected to be incurred in one of two ways: (1) either through payment of redemption prices (including premiums) in accordance with the provisions of the various indentures under which the debt securities were issued by the Companies or (2) through the payment of a purchase price for any debt securities repurchased by way of tender offer or open market repurchases.

In the former case, the applicable "make-whole" redemption premium will be calculated by reference to a fixed spread over the yield on a benchmark security (i.e., U.S. Treasury securities having a comparable remaining life). Such a provision is designed to provide the holder whose securities are being redeemed with a premium, which when added to the principal amount, would provide the investor with a yield approximately equal to the original yield on the debt securities assuming the reinvestment of that amount in the benchmark securities. The lower the then-current interest rate on the comparable U.S. Treasury securities, the higher the premium must be to provide the required yield.

In the case of a tender offer, the market price of debt securities to be repurchased will exhibit an inverse relationship with the current yield of such debt such that the price of debt securities will go up as the yield on those securities goes down. Therefore, the higher the interest rate on the repurchased debt securities compared to the then-current yield on comparable securities then the higher the price above par of such debt securities will need to be to adequately compensate the selling holder. In the current low interest rate environment, therefore, the

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changes in the transaction, as a result of an application for rehearing or appeal to the Supreme Court, or due to unforeseen events.

existing debt securities will essentially be more valuable (or expensive) and will result in increased debt redemption or repurchase costs.

At the same time as debt retirement costs may be increasing due to declining benchmark interest rates, however, customers should also benefit from those declining rates as the interest rates that the Phase-In-Recovery Bonds will bear, which will be set at issuance by reference to a spread over then current Treasury securities, may be lower, which in turn will result in customers paying lower Phase-In-Recovery Charges associated with such Phase-In-Recovery Bonds. Accordingly, customers may not be adversely impacted by increases in debt retirement costs above the estimates included in the Companies' original filing because such increases could be offset by a concurrent reduction in interest rates on the Phase-In-Recovery Bonds. Therefore, an arbitrary cap on the debt redemption premium would not properly reflect this market reality and would serve as a limitation on the Companies' ability to fully utilize the proceeds of the Phase-In-Recovery Bonds to redeem debt; even though the most beneficial approach for customers would be for the Companies to retire more debt, not less debt. Moreover, since the Companies will not have any control over benchmark interest rates at the time of issuance and redemption, it would be unfair to subject them to a cap on Financing Costs that could arbitrarily prohibit an issuance of Phase-In-Recovery Bonds that would otherwise have resulted in the statutorily-required customer savings and rate mitigation.

If the Commission insists on a form of cap for debt retirement costs, it must at least reflect the interrelated and inverse nature of debt retirement costs and interest rates and the impact that relationship has on customer savings. In this instance, the Companies propose the following structure that recognizes this relationship, but still provides protection for customers

should debt retirement costs be found to have increased without an associated increase in customer savings. The formula would be as follows:

> If the sum of total expected debt retirement cost at the time the Phase-In-Recovery Bonds are priced and the expected total interest payments is greater than 115% of the sum of the value on line 14 (columns A or E as applicable) of page 1 of 2 of Exhibit C and the aggregate nominal Interest Payments as shown in Exhibit B Column I to the Application, the Companies will submit to Staff revised exhibits to the Application that reflect the expected values at the time of bond pricing (such comparison of debt retirement costs and expected interest payments must necessary appropriate adjustments to ensure an appropriate comparison (e.g., adjusting for a different principal amount if the transaction is completed significantly earlier or later than expected)).

The structure ties the actual debt retirement costs and interest rates to the estimated debt retirement costs and interest rates set forth in the Companies' Application, and then builds in a fifteen percent range. In the circumstance where customer savings were impacted by more than fifteen percent of the values described in the foregoing paragraph, the Companies would be obligated to provide revised exhibits to the Staff to explain the differences.

For the foregoing reasons, no cap should be placed on debt retirement costs. However, if the Commission believes that a cap on debt retirement costs should be instituted, despite the risks outlined above, the cap should reflect both debt retirement costs and interest rates, as described above.

B. <u>Staff concerns related to third-party billing agent parameters should be rejected.</u>

In its comments, Staff expresses concern regarding the minimum standards proposed by the Companies for any third parties that might in the future be allowed to bill and/or collect the Phase-In-Recovery Charges. The Companies acknowledge that third parties are not currently allowed to bill and/or collect the Phase-In-Recovery Charges. Nonetheless, because third-party billing and/or collection could be authorized in the future during the life of the Phase-In-Recovery Bonds, the Companies believe that it is critical for minimum standards to be specified

in the Financing Order in order for the Phase-In-Recovery Bonds to be considered the highest credit quality instruments and bear a low rate of interest and deliver the expected savings.

The rating agencies have often cited standards for third parties that may be permitted to bill and/or collect securitized charges as a factor in their assessment of the creditworthiness of Bonds of this type.[6] For example, Fitch indicates in their ratings criteria:

> "In jurisdictions where third-party energy providers are allowed to perform consolidated billing, the 'AAAsf' stress model incorporates a test of the transaction's maximum exposure to third-party collections. To test the effect of a potential third-party default, the stress case assumes third parties take over billing for a large percentage of the customer base and default each year for the entire term of the bonds. The length of the assumed default and percentage of the customer base affected vary based on the third party's commingling restrictions contained in the statute or order." (Fitch Ratings, Rating Criteria for U.S. Utility Tariff Bonds, January 6, 2012)

Even though Ohio currently does not authorize third-party billing and/or collections, it is likely that rating agencies nevertheless will seek to stress test this transaction using an assumption that third-party billing and/or collections could occur during the term of the Phase-In-Recovery Bonds. If the statute and Financing Order lack guidance for the ratings agencies to rely upon in performing that stress test (such as the commingling restrictions referenced by Fitch), this could be viewed negatively as an "open-ended" risk.

Minimum standards should be expressly set forth in the Financing Order so that investors and rating agencies do not view this as a potential "open-ended" risk. Since the Phase-In-Recovery Bonds may have an expected maturity in excess of 20 years and there can be no guarantee that third-party billing and/or collection will not be implemented during that timeframe, a risk to investors exists that will likely be considered by the credit rating agencies in determining the appropriate rating for the Phase-In-Recovery Bonds, which will impact the

[6] Members of Applicant's financing team have prior experience in structuring and marketing these types of transactions, and are aware of the focus of investors and the rating agencies on such standards. The Applicants' structuring advisor and legal advisors are similarly experienced in this area, and are also aware of this focus and intent on it be addressed in the Final Financing Order.

ultimate interest rate borne by the Phase-In-Recovery Bonds and, in turn, the amount of required Phase-In-Recovery Charges. While the Commission may well, as is suggested in the Staff's comments, take steps as are necessary at such future time to retain the highest ratings, that does not provide the necessary assurance needed in the Financing Order for investors and rating agencies. Regardless of whether the Commission would take such steps in the future, what is needed today is prophylactic language in the Financing Order that limits the scope of this future risk. The rating agencies do not generally assume minimum standards for transactions, but rather, evaluate specific standards that exist for a given transaction. Under the Staff's recommendations, there would be no such standards on which the rating agencies could base their ratings today.

The Companies' proposal was designed to provide minimum standards, rather than prescribe specific detailed provisions that would likely, as the Staff suggests, be implemented in a subsequent proceeding. Minimum standards are not only critical for ensuring that the Phase-In-Recovery Bonds are regarded from initial issuance by investors to be of the highest credit quality and receive the highest credit ratings necessary to deliver the expected savings to customers, but are also important to be in place to minimize the potential risk to customers of any defaults by third parties that may in the future bill and/or collect the Phase-In-Recovery Charges. If such minimum standards were not in place and a third-party that had collected Phase-In-Recovery Charges failed to properly remit those charges (due to bankruptcy or otherwise), then bondholders could suffer a shortfall to the extent of such amounts, and, even if the Commission acted expeditiously to address the situation, such shortfall would be recovered from all customers through an adjustment to future Phase-In-Recovery Charges in the true-up

mechanism. In other words, failure to include such minimum standards in the Financing Order has the potential to increase the Phase-In-Recovery Charges to customers.

The minimum standards proposed by the Companies relative to third-party billing serve a similar purpose to the limitations imposed on the Companies themselves relating to their own handling of Phase-In-Recovery Charges (e.g., the Companies, as servicers, must remit Phase-In-Recovery Charges collected to the bond trustee within two business days).[7] The purpose of the provisions relating to both servicers and third parties that bill and/or collect the Phase-In-Recovery Charges is to increase the likelihood that Phase-In-Recovery Charges are forwarded to the bond trustee without default or delay. This reduces the risk that collections of Phase-In-Recovery Charges could be lost, facilitates the expected savings and protects customers.

The minimum standards proposed by the Companies are typically included, or otherwise addressed in a comparable manner, in the financing orders issued in jurisdictions where third-party billing and/or collection have been permitted. The expectation would be that, if the State of Ohio or the Commission permitted third-party billing at some point in the future, it would at that time put in place standards and requirements consistent with those proposed. Therefore, Companies believe that including the minimum standards as part of the Financing Order as they have proposed, which already generally reflect standards that exist in other jurisdictions, would be both consistent with prevailing practice and a critical factor in providing the investors and rating agencies with the assurance today that the Phase-In-Recovery Bonds are of the highest credit quality and deserving of the highest ratings.

[7] Pursuant to R.C. 4928.2311, any successor to an electric distribution utility subject to a final financing order shall be bound to all the obligations and requirements of the electric distribution utility under the final financing order.

C. <u>Staff's Form of Issuance Advice Letter Should Be Modified</u>

1. The "lowest Phase-In-Recovery bond charges" standard proposed by Staff conflicts with the Act

Staff's proposed Issuance Advice Letter[8] includes a certification to be made by the Companies that "the structuring and pricing of the PIR Bonds, as described in the Issuance Advice Letter, will result in the lowest PIR bond charges consistent with market conditions and the terms of the Financing Order".[9] Staff further states in its Comments that "[c]ompliance with the terms of the Financing Order and the filing of the issuance advice letter, including the certification from the Companies, will *ensure that no PIR Bonds are issued unless they result in the lowest PIR Charges consistent with the market conditions* and the terms of the Financing Order."[10] The imposition of such a standard is beyond the scope of authority granted by the Act and may serve to undermine the viability of the securitization.

Staff's proposed "lowest PIR bond charges" test is not part of the determination as to whether a securitization is appropriate in Ohio. In fact, there is no "lowest PIR bond charge" test or "certification" contemplated by the Act at all, and achieving such a standard is neither required nor contemplated in order to have the Commission approve a securitization transaction. The Act in R.C. 4928.232(D)(2) sets out the test that must be met and states:

> (2) Except as provided in division (D)(1) of this section, the commission shall issue a financing order under division (C) of this section if, at the time the financing order is issued, the commission finds that the issuance of the phase-in-recovery Bonds and the phase-in-recovery charges authorized by the order results in, consistent with market conditions, both measurably enhancing cost savings to customers and mitigating rate impacts to customers as compared with traditional financing mechanisms or traditional cost-recovery methods available to the electric distribution utility or, if the commission previously approved a recovery method, as compared with that recovery method.

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[8] Staff Comments, pp. 19-20 and Staff Ex. A.

[9] Staff Comments, Exh. A, Attachment 3, p. 12.

[10] Staff Comments, p. 20 (emphasis added).

The statutory standard is whether cost savings are measurably enhanced as compared to existing recovery methods, not whether the Phase-In-Recovery Charges are the lowest possible.

The standard chosen by the General Assembly is quite practical, while the alternative offered by Staff is not. Indeed, when the securitization legislation was under consideration, the General Assembly struggled mightily with the appropriate standard for approval of a securitization transaction. A "lowest cost" standard was not appropriate for the legislation for several reasons. First, it is an impossible standard to show as there may always be something else out there that theoretically could have been less expensive to some slight degree. For example, Goldman Sachs may arguably be the best, most qualified structuring advisor in the utility securitization market, but theoretically one may find someone else to fill that role with less expertise, knowledge, and experience and theoretically pay somewhat less, but that is not the outcome that anyone sought in the process. Even OCC suggests that the Companies should hire the investment banking firm with the most expertise.[11] Second, the legislature came to realize that the "lowest cost" of the transaction was not the goal, but that measurable customer savings as compared to existing recovery mechanisms were the goal.[12] The legislature refused to place the Commission in the unreasonable position of having to reject a securitization Application because they determined by some measure that it was not the absolute lowest cost, even though it would have potentially saved customers millions of dollars. Staff's proposed extra-statutory

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[11] OCC Comments, p. 20.

[12] *Compare* H.B. 364 as introduced (test is whether issuance and charges "are both reasonably expected to result in cost savings to customers and reasonably expected to mitigate rate impacts to customers as compared with traditional financing mechanisms or traditional cost-recovery methods available to the electric distribution utility") *with* Am. Sub. H.B. 364 as adopted (test is whether issuance and charges "results in, consistent with market conditions, both measurably enhancing cost savings to customers and mitigating rate impacts to customers as compared with traditional financing mechanisms or traditional cost-recovery methods available to the electric distribution utility or, if the commission previously approved a recovery method, as compared with that recovery method").

"lowest Phase-In-Recovery bond charges" certification places the Commission and Companies in the same unreasonable position. Such a certification should be rejected.

It is well settled that as a creature of statute the Commission has only that authority conferred upon it by statute. *Canton Storage and Transfer Co. v. Pub. Util. Comm.*, 72 Ohio St.3d 1, 647 N.E.2d 136 (1995); *Dayton Communications Corp. v. Pub. Util. Comm.,* 64 Ohio St.2d 302, 307, 414 N.E.2d 1051 (1980). In this instance, the Commission's authority is limited to considering and approving, modifying, suspending, or rejecting a securitization Application based upon the statutory standard set forth in R.C. 4928.232(D)(2), and not an alternative or additional standard proposed by Staff. If the Application satisfies that standard, then the Commission should issue a Financing Order approving the Application. R.C. 4928.232(D)(2).

The alternative standard proposed by Staff is not the standard that is to be met in order for the Commission to approve a securitization application. Staff's suggested approach is outside the scope of the statute and the Commission's authority. Certification by the Companies that the structuring and pricing of the Phase-In-Recovery Bonds will result in the lowest Phase-In-Recovery bond charges will not aid and cannot be a part of the Commission's determination under the Act as to whether to approve the securitization transaction. The Companies' urge the Commission to reject the certification proposed by the Staff as part of the Issuance Advice Letter, along with Staff's proposed "lowest Phase-In-Recovery bond charges" standard, as beyond the scope of the Act, and to not include those provisions in the Financing Order or Issuance Advice Letter.

2. Other modifications to the Issuance Advice Letter

In its Comments, Staff included a draft form of a proposed Issuance Advice Letter, which includes several supporting schedules. While the Companies do not oppose filing an Issuance Advice Letter with the Commission following the pricing of the Phase-In-Recovery Bonds, the Companies do have concerns with certain aspects of the draft schedules thereto. In particular, the Companies are concerned that populating the schedules, as included in Staff's Initial Comments, will not necessarily produce results consistent with the information provided in the Exhibits to the Companies' Application. The Companies recognize that the schedules attached to the Issuance Advice Letter in Staff's Initial Comments are intended to be drafts. As such, in Exhibit A to the Companies' Reply Comments, the Companies have revised the Issuance Advice Letter (as drafted by Staff) to resolve any discrepancies between such letter and either (i) the requirements of the Act[13] and (ii) the Companies' modeling (as presented in the Exhibits to their Application).

As discussed above, the Issuance Advice Letter also should be modified to delete the requirement for a certification that the Phase-In-Recovery Bonds "will result in the lowest Phase-In-Recovery bond charges."

Further, while the Companies do not object, as previously stated, to the submission of an Issuance Advice Letter to the Commission upon pricing, such a submission should be used only to confirm (i) its consistency with the form of Issuance Advice Letter approved in the final Financing Order, including the Companies' compliance with the Financing Order and Act, and (ii) the arithmetical accuracy of the information included therein. The Financing Order should

[13] Pursuant to R.C. 4928.232(H), "[t]he commission shall, in a financing order, require that after the final terms of each issuance of phase-in-recovery bonds have been established, and prior to the issuance of those bonds, the electric distribution utility shall determine the resulting phase-in-recovery charges in accordance with the adjustment mechanism described in the financing order. These phase-in-recovery charges shall be final and effective upon the issuance of the phase-in-recovery bonds, without further commission action."

clearly state this purpose, as the Act does not contemplate further Commission action after the pricing of the Phase-In-Recovery Bonds[14]. To allow any more comprehensive review of the letter at the time of its submission (i.e. post-pricing) would introduce a level of risk and uncertainty to the bond pricing process that would be difficult for the Companies, the underwriters and prospective investors to manage. As the Commission is no doubt aware, it is extremely difficult, if not impossible, to successfully close any capital markets offering that experiences a substantive change in terms after it has been priced. Moreover, the reputational damage to market participants to an offering that has priced but fails to close can be severe. If after pricing the Commission were to object to terms contained in an Issuance Advice Letter that is both consistent with its Financing Order and mathematically accurate, not only would the offering likely fail and the reputations of the Companies, the underwriters and the Commission be damaged with investors, but future securitization transactions by other Ohio utilities could be difficult to bring to market.

Finally, the Companies request that the timeframe for review of the Issuance Advice Letter be shortened from the 4 days suggested by Staff to the next business day after submission. The benefit of having that review completed by the next business day as opposed to 4 days is that it substantially reduces the risk of an unexpected obstacle to settlement in the closing process and thus allows the parties to focus fully on getting the transaction consummated. The Companies request that the Financing Order state that if the Commission does not act within the prescribed deadline the Issuance Advice Letter would be deemed accepted.

[14] *Id*.

D. Staff's recommendation to use fixed cost interest rates is acceptable

The Companies agree with the Staff recommendation that the Phase-In-Recovery Bonds will be issued with fixed rates and not rely upon floating rates.[15]

III. OCC Comments

The Companies' proposal is estimated to save customers $104 million in the aggregate, based on market conditions at the time of filing of the Application, compared to what customers otherwise will pay under the existing recovery mechanisms. Yet OCC still opposes the Application, despite the large savings it would bring to customers. Importantly, OCC never asserts that customers will not realize measurably enhanced cost savings under the Companies' proposal or that the statutory standards have not been met.

A. OCC's concerns primarily are based on a lack of information.

OCC's concerns appear to be due primarily to a lack of information and familiarity. This may be because OCC did not serve discovery requests in this proceeding until shortly before the time that initial comments were due. Although the Companies expedited the production of available information during the discovery process, OCC did not intervene until June 7, 2012, and did not serve its first set of discovery requests until June 11, 2012. As a result, OCC's concerns (as expressed on pages 19-25 of its Comments) appear to reflect a lack of information due to the fact that it did not participate sooner in the process.

OCC's first claimed "deficiency" is a lack of explanation of terms and conditions in the Application.[16] The Application contains industry standard terms for a securitization transaction as proposed by the Companies together with many terms that are defined in the Act. The OCC's

[15] Staff Comments, p. 21.

[16] OCC Comments, p. 19.

lack of familiarity with these terms should not delay or otherwise be relied upon to undermine the merits of the Application or the timing of Commission approval.

OCC's second claimed "deficiency" is a lack of support for expenses and fees,[17] which is addressed below in connection with OCC's comment regarding upfront Financing Costs.

B. OCC's concern about upfront Financing Costs, particularly debt retirement costs, is unfounded.

OCC's concern about the amount of upfront Financing Costs, including estimated fees, necessary to accomplish the securitization transaction focuses particularly on debt retirement costs. However, the estimated fees included in the Application are reasonable estimated levels for the securitization transaction proposed by the Companies. The fees actually included in Rider PIR will reflect the actual, not estimated, Financing Costs incurred by the Companies for the services needed to accomplish the issuance of the Phase-In-Recovery Bonds and the costs associated with the ongoing administration associated with the Phase-In-Recovery Bonds. The additional information that has now been provided to OCC on this topic through the Companies' discovery responses, in addition to the information provided before initial comments were due, should assist in OCC's understanding of the nature and reasonableness of the fees and should address their concerns.

The debt retirement costs incurred by the Companies to redeem or repurchase existing debt securities with the proceeds of the sale of the Phase-In-Recovery Bonds are a reflection of the spread of interest rates between current yield for the existing debt securities and the interest rate for such debt securities together with the date of maturity. The larger the spread between these two interest rates and the longer the maturity period remaining, the higher the debt retirement cost. For Ohio Edison and CEI, the probable candidates for retirement will be

[17] OCC Comments, p. 19.

maturing within the next few years. For Toledo Edison, the only existing debt securities able to be redeemed have a much longer maturity period remaining, so the corresponding debt retirement costs will be higher. Further, the debt retirement costs included in the Application were estimated at the time the Application was filed at the beginning of May 2012. The actual debt retirement costs incurred will reflect market conditions and interest rate levels at the time of the retirement. However, as stated in the Application, the Companies will not go forward with the securitization transaction unless savings can be achieved for customers in accordance with a Commission-issued Financing Order.

Notwithstanding the OCC's characterization of it as being complex,[18] the calculation of the debt retirement costs is fairly straightforward. The make-whole calculation is a mathematical calculation that uses three primary inputs: (a) current interest rates on U.S. Treasury securities with a similar remaining maturity as the debt to be redeemed; (b) interest rates on existing debt to be redeemed; and (c) the maturity period remaining on the existing debt to be redeemed. Although the make-whole approach may result in a higher retirement premium than a public tender offer or other approaches, the make-whole approach provides assurance that the debt securities will be redeemed as it requires bondholders to tender their bonds to the Companies.

Additionally, the Companies may seek to make a public tender offer for such existing debt. This approach allows the bondholder to elect whether to accept the Companies' offer for repurchase, which is based on the then-current market price for such debt plus an additional premium to incentivize the bondholders. Although this approach offers less assurance to the Companies that the desired amount of existing debt will be retired, it would, even when including transaction costs, result in a lower redemption premium in most cases. The approach

[18] OCC Comments, p. 25.

used by the Companies will depend upon market conditions at the time the retirements are undertaken.

On page 24 of its comments, OCC makes the unsupported statement about the "many benefits" that the Companies will receive as a result of the securitization transaction and subsequent debt retirement in an effort to support their view that the Companies should absorb part of the reasonably incurred costs to undertake the securitization transaction. The Act does not provide for such an approach, and the Companies should not be forced to absorb any Financing Costs incurred in connection with a transaction currently projected to save customers in excess of $100 million in the aggregate. The Companies' "benefit" is that by using the proceeds from the issuance of the Phase-In-Recovery Bonds to primarily retire existing debt, they will be able to de-lever their regulatory capital structure and should also improve their current credit metrics. Any positive impact to the Companies' credit ratings resulting from the improved credit metrics keeps the Companies' borrowing costs lower for the benefit of their customers over the long run. OCC's suggestion that the Companies should be financially penalized for undertaking this securitization transaction should be rejected as it is inconsistent with and contrary to the intent of the Act.

C. Competitive bidding for Phase-In-Recovery Bonds is not typical and does not follow market practice.

The Commission should reject the OCC's suggestion of investigating the use of a competitive bidding process to market and price the Phase-In-Recovery Bonds instead of utilizing negotiated sales to investors, coordinated through one or more underwriters, initial purchasers or placement agents. A competitive bidding process involves underwriters submitting prices at which they would purchase the Phase-In-Recovery Bonds (presumably with a view towards reselling the Phase-In-Recovery Bonds at a higher price), and the issuer selecting the underwriter(s) that submits the highest price (lowest interest cost). A negotiated sale involves a comprehensive marketing process of reaching out to investors, coordinated through the underwriter(s), with investors submitting indications of interest, and the transaction priced between the issuer and the underwriter(s) at a level where there is expected to be adequate demand for the Phase-In-Recovery Bonds to be fully distributed to investors. History has shown definitively that negotiated sales are preferred for transactions of this type. Indeed, out of the over fifty utility securitization transactions since 1997, the Companies are aware of only one that was conducted through a competitive bid, with all other transactions conducted through a negotiated sale process.

The Companies have retained a structuring advisor in connection with this securitization transaction that has extensive knowledge and experience with utility securitizations and with underwritten negotiated sales. The structuring advisor has advised the Companies that it believes an underwritten negotiated sale is the most common form of marketing for highly structured securities like the Phase-In-Recovery Bonds and that a competitive bid process is unlikely to provide a lower Phase-In-Recovery Charge than a negotiated sale. The structuring advisor believes, based on current market conditions, that obtaining the lowest interest rate is more likely

to be obtained through a broad, transparent marketing process to a broad range of institutional investors, with the full cooperation and support of the Companies in explaining the securities, rather than a competitive bid process where bids will be based upon underwriters' subjective judgments on market clearing prices. Competitive bid processes generally work very well where the securities are common, well-understood and liquid (i.e., traded frequently), as in the case of certain government- or agency- issued securities. It is not generally used in the asset-backed securities market as the particular features of securities often vary, and investors can have differing views of value. Moreover, competitive bid processes are relatively uncommon in markets such as the utility securitization market that are characterized by relatively infrequent new issuances, and therefore, less visibility in the pricing of securities.

The Companies believe that requiring a competitive bid process could jeopardize the entire securitization process. Instead, the Companies propose to sell the Phase-In-Recovery Bonds or, if applicable, the pass-through trust certificates referenced in the Application, pursuant to a negotiated sale to investors, coordinated through a group of underwriters, initial purchasers or placement agents. As of the date hereof, the Companies have not engaged underwriters, initial purchasers or placement agents with respect to this securitization transaction.

D. OCC's concern about the lack of information about the selection of Goldman Sachs is unfounded.

OCC expresses concern about the lack of information in the Application related to the Companies' selection of an investment banking firm to act as structuring advisor for the securitization transaction.[19] Specific information about consultants to be used as part of the Companies' proceedings before the Commission is rarely detailed in the Application that

[19] OCC Comments, pp. 19-20.

commences a proceeding. Through discovery, the Companies have now provided OCC with information about Goldman Sachs and the basis upon which they selected Goldman Sachs to serve as their structuring advisor for this transaction. For the benefit of the Commission, Goldman Sachs is a recognized industry leader in the field of securitization transactions, specifically including electric utility securitizations, having served as an underwriter on over $24 billion of such transactions, and having advised on the structuring on several of such securitization transactions, including two securitizations completed by a utility company affiliated with the Companies. OCC cannot legitimately be concerned about the qualifications or expertise of Goldman Sachs to serve as the Companies' structuring advisor for the securitization transaction.

E. <u>OCC's expressed need for delay is unwarranted.</u>

OCC requests that the Commission slow down the approval process and expresses concern that approval by August 1, 2012 would provide insufficient time for the Commission to complete its review. While the Commission will be the judge of that, what OCC fails to acknowledge is that the Commission Staff's review of the Companies' proposed securitization transaction and Application commenced much earlier than that of OCC. The Commission Staff has conducted an in-depth investigation of the Application, which was reflected in its detailed initial comments filed on June 25, 2012. The comments show that the Staff has been fully engaged in the process and has fully considered the content of the Application.[20] Further, the

[20] OCC also suggests that the Commission hire an outside financial advisor to assist them with the filing. Admittedly, OCC's comments were prepared without having seen the in depth comments submitted by the Commission Staff on the proposed transaction. Staff's comments were complete and reflected the necessary knowledge and expertise related to securitization transactions to advise the Commission. Staff's thorough review and assessment of the Application is sufficient given Staff's level of understanding and the straight forward nature of the securitization transaction proposed by the Companies.

Staff did not express any concern with the Companies' proposed timeline or an inability to complete its review in a thorough manner.

Delaying the approval of the transaction also places the risk of additional movements in interest rates squarely on the backs of customers. Interest rates at present are at historical lows, which makes the securitization transaction economically feasible for customers. Movements in interest rates can have meaningful impacts on expected customer savings arising from the securitization transaction. While it cannot be known today whether or how much interest rates or the market for securitization transactions will change over the next few months, it is simply in customers' interest to minimize that risk.

More importantly, each day that approval of the Application is delayed costs customers money. The Application, as filed, includes estimates that the securitization would save customers in excess of $100 million dollars in the aggregate. The savings to customers arises due to the difference between the carrying charges on the current deferrals of 6.85% and the estimated carrying charges on the Phase-In-Recovery Bonds issued in the securitization of less than 3%. Decreasing this interest rate is the direct benefit to customers of engaging in the securitization transaction. Each day that Commission action on the Application is delayed, at OCC's behest, the current deferrals continue to accrue interest at 6.85% and thus the present value of customer savings would be expected to decrease. It is unlikely that customers would agree with OCC's delaying tactics.

IV. The Statutory Provisions Reflected in Paragraph 21 of the Application

The Staff and OCC were silent in their comments related to paragraph 21 of the Companies' Application.[21] This paragraph provides to the Commission a listing of provisions that are included in the Act that need to be set forth in the Financing Order as well. Customarily, these types of structural elements and express regulatory authorizations and confirmations are required to be included in a Financing Order for ratings and marketing purposes even if already included in the underlying statutory provisions. Since neither Staff nor OCC voiced any objection to expressly including the provisions of Paragraph 21 of the Application into the Financing Order, the Companies would specifically request the Commission to so include them along with all other provisions for which inclusion was specifically requested in the Application.

V. Conclusion

The Application satisfies all statutory requirements for a securitization and will benefit customers as the securitization will measurably enhance cost savings to customers and mitigate rate impacts to customers as compared to the existing cost recovery methods of the Companies.

[21] Application, pp. 21-26.

There is no reason for delaying approval of the Application and, indeed, every reason to issue a Financing Order in a timely manner. For the foregoing reasons, the Companies respectfully request that the Commission approve the Application as filed and issue a Financing Order consistent with its provisions.

Respectfully submitted,

/s/ James W. Burk

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ATTORNEY FOR
OHIO EDISON COMPANY
THE CLEVELAND ELECTRIC
ILLUMINATING COMPANY
THE TOLEDO EDISON COMPANY

Exhibit A

FORM OF ISSUANCE ADVICE LETTER
_____day _____ __, 20___

Case No. 12-1465-EL-ATS

The Public Utilities Commission of Ohio

SUBJECT: ISSUANCE ADVICE LETTER FOR PHASE-IN RECOVERY BONDS

Pursuant to the Financing Order issued *In the Matter of the Joint Application of Ohio Edison Company, The Cleveland Electric Illuminating Company, and The Toledo Edison Company for Authority to Issue Phase-In-Recovery Bonds and Impose, Charge and Collect Phase-In-Recovery Charges and For Tariff Approvals in Case No. 12-1465-EL-ATS (the Financing Order),* each Applicant hereby submits, no later than the end of the first business day after the pricing of this series of PIR Bonds, the information referenced below. The issuance Advice Letter is for the PIR Bonds series____, tranches_____. Any capitalized terms not defined in this letter shall have the meanings ascribed to them in the Financing Order.

PURPOSE:

This filing establishes the following:

(a) The total amount of Phase-In Recovery Charges being securitized;
(b) Confirmation of compliance with issuance standards;
(c) The actual terms and structure of the PIR Bonds being issued;
(d) The initial Phase-In-Recovery Charges for retail users; and
(e) The identification of the SPE

PHASE-IN RECOVERY CHARGES BEING SECURITIZED:

The total amount of Phase-In Recovery Charges being securitized (the Securitized Phase-In Recovery Charges) is presented in Attachment-1, Schedule C.

COMPLIANCE WITH ISSUANCE STANDARDS

The Financing Order requires Applicants to confirm, using the methodology approved therein, that the actual terms of the Phase-In Recovery (PIR) Bonds result in compliance with the standards set forth in the Financing Order. These standards are:

1. In aggregate the total amount of revenues expected to be billed under the Financing Order is less than the revenue that would be expected to be billed using the existing cost recovery methods of the Applicants (See Attachment 2, Schedule A);

2. In aggregate the present value of revenues expected to be billed under the Financing Order is less than the present value of the revenue that would be expected to be billed using the existing cost recovery methods of the Applicants (See Attachment 2, Schedule A);

3. The PIR Bonds will be issued in one or more series comprised of one or more tranches having final maturities of ___years and legal final maturities not exceeding ___ years from the date of issuance of such series (See Attachment 1, Schedule A).

4. Certification of Applicants as to certain matters with respect to PIR Bonds (See Attachment 3).

ATTACHMENT-1
SCHEDULE A

ACTUAL TERMS OF ISSUANCE

PIR Bond Series: _____

PIR Bond Issuer: [SPE]

Trustee:

Closing date: _____, 20___

Bond ratings: S&P ____, Fitch ____, Moody's ____

Amount Issued: $ _____

PIR Bond Issuance Costs: See Attachment_____ Schedule___

PIR Bond Support and Servicing: See Attachment _____ Schedule ___

Tranche	Coupon Rate	Expected Final Maturity	Legal Final Maturity
A-1		__/__ /____	__/__ /____
A-2		__/__ /____	__/__ /____
A-3		__/__ /____	__/__ /____

Effective Annual Weighted Average Interest Rate of the PIR Bonds	___%
Life of Series:	___years
Weighted Average Life of Series:	___years
Call Provisions (including premium, if any):	
Target Amortization Schedule:	
Target Final Maturity Dates:	
Legal final Maturity Dates:	
Payments to Investors:	Semiannually Beginning _____ __, 20___
Initial annual Servicing Fee as a percent of original PIR Bond principal balance (specified by applicant):	____%

ATTACHMENT-1
SCHEDULE B

INITIAL PHASE-IN RECOVERY CHARGES

To be submitted in accordance with the form of Exhibit F – Attachment 1 to the Application.

ATTACHMENT-1
SCHEDULE C

CALCULATION OF SECURITIZED PHASE-IN RECOVERY CHARGES

	OE	CEI	TE	Total
Amount permitted to be securitized by Financing Order	**$**	**$**	**$**	**$**
TOTAL SECURITIZED PHASE-IN RECOVERY CHARGES	**$**	**$**	**$**	**$**

ATTACHMENT-1
SCHEDULE D

UP-FRONT FINANCING COSTS

To be submitted in accordance with the form of Exhibit C (Page 1 of 2) to the Application (for a Multiple Utility Level Issuance or Single Combined Issuance, as the case may be).

ATTACHMENT-2
SCHEDULE-A

PHASE-IN RECOVERY BOND REVENUE REQUIREMENT INFORMATION

To be submitted in accordance with the form of Exhibit B to the Application.

ATTACHMENT-2
SCHEDULE-B

ESTIMATED ONGOING FINANCING COSTS

To be submitted in accordance with the form of Exhibit C (Page 2 of 2) to the Application (for a Multiple Utility Level Issuance or Single Combined Issuance, as the case may be).

ATTACHMENT-3

CERTIFICATION OF COMPLIANCE

[FE Companies Letterhead]

Date:_____ __, 20___

Re: Joint Application of Ohio Edison Company, The Cleveland Electric Illuminating Company, and The Toledo Edison Company, Case No. 12-1465-EL-ATS

Applicants, Ohio Edison, Cleveland Electric, and Toledo Edison submit this Certification pursuant to Ordering Paragraph No___ of the Financing Order *In the Matter of the Joint Application of Ohio Edison Company, The Cleveland Electric Illuminating Company, and The Toledo Edison Company for Authority to Issue Phase-In-Recovery Bonds and Impose, Charge and Collect Phase-In-Recovery Charges and For Tariff Approvals in Case No. 12-1465-EL-ATS (the Financing Order).* All capitalized terms not defined in this letter shall have the meanings ascribed to them in the Financing Order.

In its issuance advice letter dated _____ __, 20___, the Applicant has set forth the following particulars of the PIR Bonds:

Name of PIR Bonds: _____
PIR Bond Issuer:
SPE:
Trustee:
Closing date: _____, 20___
Amount Issued: $ _____
Expected Amortization Schedule: See Attachment 2, Schedule A to the Issuance Advice Letter
Distributions to Investors (quarterly or semi-annually):
Weighted Average Coupon Rate: ___%
Weighted Average Yield: ___%

Based upon the information reasonably available to the officers, agents, and employees of the Applicants, the Applicants hereby certify that the structure and pricing terms of the PIR Bonds comply with the Financing Order and the Act.

The Applicants are delivering this Certification to the Commission solely to assist the Commission in establishing compliance with the aforementioned standard. The Applicants specifically disclaim any responsibility to any other person for the contents of this Certification, whether such person claims rights directly or as a third-party beneficiary.

Respectfully submitted,

OHIO EDISON COMPANY
THE CLEVELAND ELECTRIC ILLUMINATING COMPANY
THE TOLEDO EDISON COMPANY

By:_____
Name:_____
Title:_____

Certificate of Service

I hereby certify that the foregoing Reply Comments of Ohio Edison Company, The Cleveland Electric Illuminating Company, and The Toledo Edison Company were served this 9th day of July, 2012 by electronic mail on the persons listed below.

/s/ James W. Burk
James W. Burk

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Case No(s). 12-1465-EL-ATS

Summary: Comments REPLY COMMENTS OF APPLICANTS, OHIO EDISON COMPANY, THE CLEVELAND ELECTRIC ILLUMINATING COMPANY, AND THE TOLEDO EDISON COMPANY
electronically filed by Ms. Tamera J Singleton on behalf of Ohio Edison Company and The Cleveland Electric Illuminating Company and The Toledo Edison Company