

**STATE OF NEW HAMPSHIRE
BEFORE THE
PUBLIC UTILITIES COMMISSION**

DOCKET NO. DE 14-238

**2015 PUBLIC SERVICE COMPANY OF NEW HAMPSHIRE
RESTRUCTURING AND RATE STABILIZATION AGREEMENT**

JOINT DIRECT TESTIMONY OF PHILIP J. LEMBO AND EMILIE G. O'NEIL

July 6, 2015

1 **Q. Please state your names and business addresses.**

2 A. Our names are Philip J. Lembo and Emilie G. O'Neil. Our business address is
3 One NSTAR Way, Westwood, Massachusetts.

4 **Q. By whom are you employed and in what capacity?**

5 A. [Witness Lembo] I am Vice President and Treasurer for Eversource Energy,
6 formerly known as Northeast Utilities ("Eversource").

7 A. [Witness O'Neil] I am the Director of Corporate Finance and Cash Management
8 for Eversource.

9 **Q. Please describe your education.**

10 A. [Witness Lembo] In May 1983, I earned a Master of Business Administration
11 from Boston University. In 1977, I earned a Bachelor of Science, Business
12 Administration, from Salem State University.

13 A. [Witness O'Neil] In May 1986, I earned a Master of Business Administration
14 with a concentration in Accounting and Finance from Cornell University. In May
15 1982, I earned a Bachelor's degree in Economics and Mathematics from the
16 Barnard College of Columbia University.

17 **Q. Please summarize your professional experience.**

18 A. [Witness Lembo] I joined Boston Edison Company in 1983 as Internal Audit
19 Manager. Over the past 32 years, I have held various positions of increasing
20 responsibilities within Boston Edison Company and NSTAR. In 2009, I was
21 appointed to the position of Vice President and Treasurer of NSTAR (the
22 successor entity to Boston Edison Company following the merger of Boston

1 Edison Company's parent company, BEC Energy, and Commonwealth Energy
2 System in 1999) and its subsidiaries. Upon consummation of the Northeast
3 Utilities and NSTAR merger in April 2012, I was appointed to my present
4 position as the Vice President and Treasurer of Eversource and its subsidiaries.

5 A. [Witness O'Neil] I joined Boston Edison Company in 1987 in the Corporate
6 Finance and Cash Management group. Over the past 28 years, I have held
7 various positions of increasing responsibility within Boston Edison Company and
8 NSTAR. I was promoted to the position of Director, Corporate Finance and Cash
9 Management of NSTAR in 1999. Upon consummation of the Northeast Utilities
10 and NSTAR merger in April 2012, I was appointed to my present position as
11 Director, Corporate Finance and Cash Management of Eversource and its
12 subsidiaries.

13 **Q. Please describe your duties and responsibilities for Eversource.**

14 A. [Witness Lembo] I have overall responsibility for Corporate Finance and Cash
15 Management, Investment Management, Claims and Insurance and Enterprise
16 Risk Management. I have previously testified in eleven finance-related
17 applications:

18 Public Service Company of New Hampshire, DE 13-156 (2013) (Issuance of
19 Long-term debt); NSTAR Gas Company, D.P.U. 09-57 (2009) (issuance of first
20 mortgage bonds); NSTAR Gas Company, D.P.U. 15-01 (2015) (issuance of first
21 mortgage bonds); NSTAR Gas Company, D.P.U. 14-150 (2014) (request for
22 approval of an increase in rates); NSTAR Electric Company, D.P.U. 13-133

1 (2013) (2014-2015 Finance Plan); NSTAR Electric Company, D.P.U. 12-32
2 (2012-2013 Finance Plan); NSTAR Electric Company, D.P.U. 08-124 (2008)
3 (2009-2010 Finance Plan); NSTAR Electric Company, D.P.U. 07-43 (2007)
4 (2007-2008 Finance Plan); Boston Edison Company, D.T.E. 03-129 (2003)
5 (2004-2005 Finance Plan), Boston Edison Company, D.T.E. 00-62 (2000) (2001-
6 2002 Finance Plan); and Commonwealth Electric Company, D.T.E. 02-51 (2002)
7 (issuance of long-term debt).

8 A. [Witness O'Neil] My primary responsibilities include cash management,
9 development and implementation of long-term financing plans, lease financings,
10 capital structure and credit. I have testified in sixteen previous financing related
11 applications, including the eleven proceedings referenced by Mr. Lembo, along
12 with Boston Edison Company, D.P.U. 92-244 (1992); Boston Edison Company,
13 D.P.U. 92-253 (1992), Boston Edison Company, D.P.U. 94-160 (2004); Boston
14 Edison Company, D.T.E. 98-118 (1998) (securitization); and Boston Edison
15 Company and Commonwealth Electric Company, D.T.E. 04-70 (2004)
16 (securitization).

17 **Q. What is the purpose of your testimony?**

18 A. The purpose of our testimony is to describe securitization and its benefits and to
19 explain why it is critical for the securitization bonds to be assigned a Triple-A
20 bond rating by the rating agencies. We will also give an overview of what
21 criteria are essential to achieve the Triple-A rating.

1 **Q. Please describe securitization.**

2 A. Securitization is the financing of a specific asset through the issuance of
3 securities, frequently referred to as “asset-backed securities”. For debt service
4 and repayment of principal, these securities rely solely on the revenue stream of
5 the underlying asset. Securitization is a form of “structured financing,” the use of
6 which by electric utilities New Hampshire Law, at RSA 369-B:1, III, finds “will
7 facilitate reductions in transmission and distribution rates for all customer
8 classes”.

9 In Senate Bill 221, “AN ACT relative to electric rate reduction financing,” which
10 the New Hampshire Legislature approved this session, the Legislature expressly
11 found the use of securitization to be in the public interest by adding a new
12 subsection XVI to RSA 369-B:1:

13 It is in the public interest for the commission to issue a finance
14 order that is subject to the requirements of this chapter and that
15 securitizes any stranded costs resulting from the divestiture of all
16 or some of PSNH’s generation assets, if the commission
17 approves the 2015 settlement proposal or otherwise orders
18 divestiture of all or some of PSNH’s generation assets.

19 In the case of Rate Reduction Bonds (“RRBs”) the asset is the transition property,
20 or “RRB Property” which is the irrevocable property right to receive cash flows
21 generated from the billing and collection of a non-bypassable “RRB Charge”.
22 RSA 369-B:2, XV defines “RRB Property.” Collections of the RRB Charge
23 provide the cash flow that will pay the principal and interest and other costs of
24 the RRBs.

25 The following describes how the process would work at a high level.

Pursuant to RSA Chapter 369-B, as amended by SB 221, the Commission will be asked to issue a "Finance Order" as defined in RSA 369-B:2, V authorizing the use of securitization to finance stranded costs resulting from the divestiture of PSNH's generation assets.

PSNH will create a Special Purpose Securitization Entity ("SPSE") that meets the definition of a "financing entity" under RSA 369-B:2, VI. PSNH will sell its rights in the RRB Property to the SPSE. The SPSE will finance the purchase by issuing RRBs in the capital markets. The RRBs will be payable solely from cash flows from the RRB Charge.

Q. Has PSNH issued RRBs previously?

A. Yes, PSNH has completed the two securitization financings listed below using the same structure as described above. The 2001 issuance securitized the Seabrook stranded costs. The 2002 issuance securitized the stranded costs related to a PURPA rate order obligation.

<u>Year</u>	<u>\$</u>	<u>Maturity</u>	<u>Rate</u>
2001	\$525 million	5/1/2013	4.57%-6.48%
2002	\$50 million	2/1/2008	4.58%

Q. Why is the Triple-A Bond Rating, the highest rating issued by the rating agencies, critical to the RRB transaction?

A. All utility RRB issuances in the past twenty years have been rated Triple-A. The investors will expect the bonds to be rated Triple-A. If RRBs are rated below Triple-A it will send a confusing signal to the market that the transaction is

1 abnormal and risky. Many investors will not want to participate and the ones
2 who do will demand a higher interest rate.

3 If the RRBs meet all of the criteria established by the rating agencies they should
4 be assigned a Triple-A rating. The higher the bond rating the lower the interest
5 costs paid to investors and the greater the benefit to customers.

6 **Q. How do customers benefit from securitization?**

7 A. Since RRBs are expected to be rated Triple-A, they can be issued at a cost that is
8 lower than the Company's weighted average cost of capital. The financing
9 savings would result in lower rates to customers.

10 **Q. Will the debt be included on PSNH's balance sheet even if it is non-recourse**
11 **to PSNH?**

12 A. Yes, the debt will appear on the balance sheet of PSNH. However, the Rating
13 Agencies are expected to exclude it from their metric calculations. In other
14 words, it would be as if the debt didn't exist on PSNH's balance sheet.

15 **Q. Who will act as Servicer of the RRB Property?**

16 A. As with the prior two securitizations, PSNH will act as Servicer for the RRB
17 Property and will be responsible for calculating, billing, collecting and remitting
18 the RRB Charge from all customers that are obligated to pay them. RSA Chapter
19 369-B, the law creating and allowing the use of securitization, discusses the role
20 of the Servicer at RSA 369-B:4, IV.

1 **Q. Will PSNH be paid a Servicing Fee?**

2 A. Yes. In order to support the SPSE's legal status separate and apart from PSNH,
3 PSNH will be paid a market-based Servicing Fee for the administration costs of
4 servicing the RRB Property. The annual Servicing Fee set forth in the Servicing
5 Agreement, payable semi-annually, will be equal to approximately 0.10% of the
6 amount of RRBs issued. It should be noted that the 0.10% servicing fee is a
7 "market based" rate that would need to be paid to any entity acting as the servicer
8 of the bonds.

9 **Q. What are the criteria the rating agencies consider in establishing the credit**
10 **rating of RRBs?**

11 A. There are several criteria that the rating agencies will evaluate. These include,
12 but are not limited to, the following:

- 13 1. Bankruptcy-remoteness from the utility
- 14 2. Non-bypassability of the RRB charge and State non-impairment pledge
- 15 3. Allowance for a successor servicer
- 16 4. Credit enhancement
- 17 5. Irrevocability

18 **Q. Please describe the importance of the first criterion, the bankruptcy-**
19 **remoteness from the utility.**

20 A. The combination of the bankruptcy-remote character of the SPSE and the legal
21 true sale of the RRB Property allows for the highest possible credit rating for the
22 RRBs and the greatest possible savings to PSNH's retail customers. PSNH will

1 legally sell the RRB Property to the SPSE. Therefore if PSNH were to become
2 the subject of a bankruptcy proceeding, the RRB Property would not be subject
3 to the claims of PSNH's creditors. New Hampshire law recognizes the need for
4 bankruptcy-remoteness at RSA 369-B:6, V. Although PSNH will collect the
5 billed RRB Charge as Servicer for the RRBs, for legal purposes, the RRB
6 Property will remain isolated to the extent possible from PSNH's revenues and
7 assets.

8 **Q. Please discuss the importance of the second criterion, the non-bypassability**
9 **of the RRB Charge and the state non-impairment pledge in the legislation.**

10 A. In order to obtain the Triple-A rating, legislation needs to be in place and
11 specifically state that the RRB Charge will be non-bypassable, in that it will be
12 imposed on all retail customers within PSNH's Service Territory whether they
13 purchase electricity from PSNH or from a third party supplier. RSA 374-F:3
14 discusses and provides authority for the creation of such a non-bypassable
15 charge.

16 RRBs are not direct obligations of the state and are not guaranteed by the state.
17 However, the legislation needs to contain a state non-impairment pledge, wherein
18 the state agrees that it will not limit or alter the RRB Charge or the Finance Order
19 until the RRBs have been fully paid off. Such a state pledge is included in
20 present New Hampshire law at RSA 369-B:1, IV and RSA 369-B:6, II.

1 **Q. The third important criterion is the allowance of a successor servicer. Why**
2 **is this important?**

3 A. The transaction must provide the ability to replace PSNH as servicer with an
4 alternate servicer in the event of a substantial decline in PSNH's credit rating,
5 insolvency or the failure to perform any of the duties of servicer.

6 **Q. On the fourth characteristic of credit enhancement, please explain the types**
7 **of credit enhancement considered significant by rating agencies.**

8 A. Credit enhancement is necessary in asset-backed transactions to provide investors
9 with added assurance that they will recover their investment. In RRB
10 transactions, rating agencies primarily look for various types of credit
11 enhancement, including the right to make periodic adjustments to the RRB
12 Charge, and a reserve account.

13 Periodic adjustments to the RRB Charge are intended to ensure that "actual"
14 collections are not over or under relative to forecasted collections. Several
15 factors could contribute to actual RRB collections differing from what was
16 forecast including the impact of the variability of energy sales and changes in
17 payment and charge-off patterns. The Servicer requires the ability to adjust
18 periodically the RRB Charge, up or down, by an RRB Charge true-up mechanism
19 ("RRB Charge True-Up Mechanism").

20 The RRB Charge True-Up Mechanism is viewed by the rating agencies as the
21 primary form of credit support. These periodic adjustments provide greater

1 assurance that the collection of aggregate RRB Charges will be sufficient to
2 satisfy debt service obligations to the RRB holders and other fees and expenses
3 of the transaction for the entire term of the RRBs, in accordance with the
4 expected amortization schedule. The credit analysis of RRBs will be affected
5 favorably by the RRB Charge True-Up Mechanism.

6 The Reserve Subaccount is another form of credit enhancement. The Reserve
7 Subaccount is designed to address shortfalls in RRB Charge collections and
8 thereby give investors and rating agencies additional comfort that the collection
9 of RRB Charges will be sufficient to pay interest and principal on the RRBs in a
10 timely manner. The funds for the Reserve Subaccount are contributed by PSNH
11 to the SPSE prior to the issuance of the RRBs. The amount required is typically
12 approximately 0.5% of the issuance size. Once the bonds are fully amortized all
13 the funds in the Reserve Subaccount are remitted back to PSNH.

14 **Q. With respect to the fifth characteristic which is important to rating agencies,**
15 **please describe the requirement that the Finance Order clearly state that the**
16 **RRB Charge is irrevocable.**

17 **A.** Pursuant to the underlying securitization law at RSA 369-B:3, II, the Finance
18 Order and the RRB Charge established thereby shall be irrevocable, and the
19 State, the Commission, nor any other agency or government entity shall have the
20 authority to rescind, alter or amend the Finance Order or the RRB Charge.

1 **Q. What else will need to be contained in the Finance Order prior to the**
2 **issuance of the RRBs?**

3 A. The Finance Order will be required to do the following:

- 4 (1) Approve the issuance of RRBs,
- 5 (2) Approve the organization and capitalization of the SPSE,
- 6 (3) Establish the RRB Charge,
- 7 (4) Provide for the RRB Charge True-Up Mechanism,
- 8 (5) Approve the general terms and structure of the bonds,
- 9 (6) Approve the servicing fee,
- 10 (7) Approve the servicing of the bonds by PSNH as the initial servicer of the
- 11 RRBs, or any successor servicer, and
- 12 (8) Declare the Finance Order irrevocable

13 **Q. When will PSNH be requesting the issuance of the Finance Order?**

14 A. PSNH will return to the Commission to obtain the Finance Order after bids have
15 been received on the assets being divested, as that is when the size of the
16 securitization financing contemplated in the 2015 settlement proposal can be
17 determined. PSNH will ask that the requested Finance Order be issued at the
18 same time as the Commission's order reviewing the bids received on the assets
19 and approving the sale of the assets to the successful bidder(s) to allow for the
20 most expeditious issuance of the RRBs.

1 **Q. Does this conclude your testimony?**

2 **A. Yes it does.**