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(PECO Stmt.)
20-EGS)

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

APPLICATION OF PECO ENERGY COMPANY
FOR APPROVAL OF ITS RESTRUCTURING PLAN
UNDER SECTION 2806 OF THE PUBLIC UTILITY CODE

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TESTIMONY
OF

J. BARRY MITCHELL

REGARDING THE ENRON CHOICE PLAN

DOCKETED
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Regarding the Petition of
Enron Energy Service Power, Inc.
for Approval of Enron's "Choice Plan"

DOCUMENT
FOLDER

November 7, 1997

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TESTIMONY OF J. BARRY MITCHELL

I. QUALIFICATIONS

Q. Please state your name and business address.

A. J. Barry Mitchell, 2301 Market Street, Philadelphia, Pennsylvania.

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

A. I am the Vice President of Finance and Treasurer of PECO Energy Company ("PECO Energy" or the "Company").

Q. Have you testified before in this proceeding?

A. Yes, I testified earlier this year in PECO Energy's securitization proceeding regarding PECO Energy's proposal for issuance of Transition Bonds and use of proceeds before the Pennsylvania Public Utility Commission (the "Commission"), Docket R-00973877. I also submitted Rebuttal Testimony concerning PECO Energy's financial integrity under the intervenors' disallowance proposals in this proceeding, Docket R-00973953.

II. PURPOSE OF TESTIMONY AND SUMMARY OF CONCLUSIONS

Q. What are the purposes of your testimony?

1 A. The first purpose of my testimony is to describe the catastrophic effect of the Choice
2 Plan (the "Enron Plan") submitted by Enron Energy Services Power, Inc. ("Enron")
3 on the Company's financial integrity. The second purpose of my testimony is to
4 describe the fatal flaws in the securitization proposal described in the Enron Plan and
5 related testimony. Finally, I will testify as to the inappropriateness of the financial
6 structure of Enron as the proposed provider of last resort and the lack of financial
7 accountability of Enron under the Enron Plan.

8
9 **Q. Please summarize your conclusions.**

10 A. First, the Enron Plan is not in the best interest of consumers and will not promote
11 competition because it will destroy the financial integrity of PECO Energy. This will
12 seriously impair the Company's ability to provide safe, reliable service to customers
13 — who under the Enron Plan must rely on the Company, and only the Company, for
14 that service — and to be a healthy, viable competitor in the emerging electric
15 marketplace.

16
17 Second, the securitization proposal described in the Enron Plan and related testimony
18 is not achievable. Therefore, the Enron Plan, which is totally dependent on
19 securitization, will not provide the savings to consumers promised by Enron or,
20 indeed, any savings at all.

1 Finally, the "project finance" structure of Enron under the Enron Plan and the lack of
2 financial accountability of Enron, even to the Commission itself, is inappropriate and
3 inadequate to satisfy the obligation to serve consumers which is the essential role of
4 the provider of last resort.

5 6 III. FINANCIAL INTEGRITY 7

8 **Q. What is meant by the term "financial integrity"?**

9 A. Generally, financial integrity refers to the financial "health" of a company. A
10 company that has financial integrity is able to generate funds, both internally through
11 its own operations and externally by access to the debt and equity markets, to cover
12 all of the costs of its operations (including debt service), to fund needed investments
13 and to provide an adequate income return to shareholders. The ability to access
14 capital markets is an especially important indicator of financial health of capital-
15 intensive companies, such as electric utilities which have an obligation to serve
16 consumers.

17
18 In addition, financial integrity means that a company has sufficient flexibility in its
19 financial position to respond to unanticipated events. Put differently, a company that
20 can remain viable only if all unanticipated events are positive is not a company that
21 has financial integrity.
22

1 Q. How do you determine a company's financial integrity?

2 A. Primarily, a company's financial integrity is determined by analyzing its net cash flow
3 and assessing its ability to access the debt and equity markets for external capital.

4 Because I gave a comprehensive description of financial integrity in my earlier
5 Rebuttal Testimony before the Commission in the proceeding referred to on page 1, I
6 will provide a summary of that description.

7
8 A company's ability to internally generate funds is measured by its cash flow. A
9 company's access to the short-term debt market is determined by its creditworthiness,
10 which is reflected in the rating of its commercial paper. A company's ability to
11 access the long-term debt market is also determined by its creditworthiness, which is
12 reflected by its bond rating, which is in turn derived from criteria such as funds from
13 operations as a percentage of total debt, funds from operations interest coverage, the
14 ratio of total debt to total capital, pre-tax interest coverage, and net cash flow as a
15 percentage of capital expenditures. A company's ability to access the common stock
16 equity market is determined by its ability to provide an adequate total return to its
17 shareholders, commonly demonstrated by earnings and dividends per share and cash
18 flow per share. Taken together, these measures are generally accepted in the
19 financial community as key measures for determining a company's financial integrity.

20

1 **Q. Explain the relationship between a utility company's financial integrity and its**
2 **ability to provide safe and reliable service.**

3 A. A company's ability to provide safe and reliable service depends on its ability to
4 generate cash flows sufficient to maintain the assets needed to provide that service,
5 such as its distribution and transmission networks, as well as to finance future
6 improvements and upgrades necessitated by regulations and new technology. If a
7 company has inadequate cash flow and is unable to access external sources of capital
8 on reasonable terms, it will be unable to make the capital commitments necessary for
9 it to provide this safe and reliable service. Such a company could not compete
10 effectively in a competitive generation market.

11
12 **Q: Why is PECO Energy's financial integrity essential to consumers under the**
13 **Enron Plan if Enron is going to "step into the shoes of PECO"?**

14 A: Even though Enron wants the Commission to appoint Enron as the provider of last
15 resort for generation, Enron's obligation to serve is conditioned on PECO Energy
16 providing the necessary capacity and energy under the Power Purchase Agreement.
17 Likewise, Enron's ability to provide metering, billing and customer services will be
18 totally dependent on the Company's performance under the MBC Services
19 Agreement. Finally, PECO Energy, as the electric distribution company, must
20 continue to provide transmission and distribution services. The Company's inability
21 to maintain financial integrity would seriously jeopardize the Company's ability to
22 continue to provide all or any of these essential services. Additionally, impairment of

1 the Company's financial integrity would adversely affect competition by removing
2 PECO Energy as a local Pennsylvania competitor within the new competitive market.
3 In other words, Enron would effectively reduce competition despite its claims of
4 encouraging it. These results would be counter to the legislature's express statutory
5 policy of encouraging competition while "maintaining the safety and reliability of the
6 electric system for all parties," which, in the words of the Pennsylvania Assembly,
7 "is of the utmost importance to the health, safety and welfare of the citizens of the
8 Commonwealth."

9
10 **IV. EFFECT OF THE ENRON PLAN ON THE COMPANY'S**
11 **FINANCIAL INTEGRITY**
12

13 **Q. Have you calculated the effect of the Enron Plan on PECO Energy's financial**
14 **integrity?**

15 **A.** Yes. While the analysis considers various aspects of the Enron Plan, it focuses
16 principally on the financial impact on the Company of issuing \$5.461 billion of
17 Transition Bonds as required by the Enron Plan.
18

19 **Q. Please summarize those effects.**

20 **A.** • The Enron Plan would result in significant downgrading of the Company's
21 mortgage bond rating to junk bond status through 2005. With a junk bond
22 rating at the levels projected, the Company's access to the debt market would

1 be seriously constrained and that access, to the extent available, would come at
2 significantly increased cost.

- 3
- 4 • The Company would experience a negative net cash flow of \$709 million in
5 1999 and a cumulative negative net cash flow of \$2.9 billion through 2005.

6 The Company would have insufficient internally generated funds to make
7 capital expenditures, to maintain, improve or upgrade existing generation,
8 transmission and distribution facilities or to respond to technological or other
9 advances that might enhance the system for consumers.

- 10
- 11 • Earnings per share would show a loss in 1999 and recover only slightly during
12 the period 2000 to 2005.

- 13
- 14 • I expect that the price of the Company's common stock would drop
15 significantly.

- 16
- 17 • The Company would violate the financial covenant under its \$900 million
18 credit facility — its principal outside source of short-term liquidity.

19

1 Q. In your previous testimony, you used the Standard & Poor's ("S&P") measures
 2 to project the Company's mortgage bond rating. Can you show the results of the
 3 Enron Plan on the S&P measures?

4 A. Table JBM-1 provides the pro forma results for the key S&P measures and a
 5 projected mortgage bond rating associated with those results. These are pro forma
 6 results showing our assessment of where the values of the S&P measures derived
 7 from the Enron Plan would place us with respect to the rating criteria.

8 **TABLE JBM-1**

9 **Effects of Enron Plan Proposal on Key Financial Criteria**

10

11

	1999	2000	2001	2002	2003	2004	2005
12 Funds from Operations/ 13 Average Total Debt	13.4%	14.9%	14.2%	10.9%	8.3%	7.3%	6.0%
14 Funds from Operations/ 15 Interest Coverage	2.63x	2.59x	2.53x	2.21x	1.93x	1.80x	1.67x
16 Total Debt/Total Capital	57.2%	61.0%	63.5%	66.9%	70.8%	74.3%	78.0%
17 Pre-Tax Interest Coverage	0.38x	0.89x	1.46x	1.39x	1.28x	1.19x	1.06x
18 Net Cash Flow/Capital 19 Expenditures	28.6%	49.5%	42.6%	25.2%	12.2%	10.2%	4.1%
20 Projected Bond Rating	B or 21 below	B or 22 below	B or 23 below	B or 24 below	B or 25 below	B or 26 below	B or 27 below

28 Q. What impact on the Company's bond rating would you expect from these changes
 29 to the key bond measures?

30 A. I would expect the Company's bond rating to be downgraded from its current
 31 investment grade rating of BBB+ to below investment grade, or junk bond status,
 32 where it would remain through 2005.

1 **Q. How would this expected downgrading affect the Company's ability to access the**
2 **long-term debt market?**

3 A. Ratings of B or below would, at best, significantly impair the Company's ability to
4 access the long-term debt markets in amounts necessary to provide safe and reliable
5 service. Even if available, such debt would bear interest at rates significantly higher
6 than investment grade securities.

7
8 **Q. What effect would the Enron Plan have on the Company's commercial paper**
9 **rating and its access to short-term liquidity?**

10 A. Our current commercial paper rating is A2/P2. Based on the projected bond ratings
11 noted above, PECO Energy would have no access to the commercial paper market.

12
13 The ability to obtain bank financing would also be impaired because most banks use a
14 risk adjusted pricing model to determine credit availability and pricing spreads to
15 customers. A downgrading of long-term bond and commercial paper ratings would be
16 viewed by banks as an increased credit risk of PECO Energy. Based on the projected
17 bond ratings noted above, the banks would either withhold credit entirely or severely
18 limit their credit availability and demand significant additional compensation for this
19 increased risk. Taken together, these effects would cripple the Company's ability to
20 manage its operations with the assistance of commercial paper borrowing and other
21 short-term debt.

22

1 **Q. What effect would the Enron Plan have on PECO Energy's existing credit**
2 **facilities?**

3 A. The commitment fees and cost of borrowings payable by the Company under its \$900
4 million credit facility authorized by the Commission on September 12, 1997 are
5 directly related to the debt ratings of the Company's mortgage bonds. A decrease in
6 those ratings, particularly to junk bond levels, would substantially increase the cost to
7 the Company of those facilities, further exacerbating the devastation of its financial
8 integrity. Furthermore, the issuance of the Transition Bonds under the Enron Plan
9 would cause the Company to violate the debt to equity ratio covenant under the
10 Company's \$900 million credit facility. This would preclude the Company from
11 borrowing under that facility and, with respect to any outstanding borrowings, trigger
12 a default by the Company under that facility.

13
14 **Q. How would the Enron Plan affect the Company's access to the equity market?**

15 A. To the extent that the ability to access one market is impaired, the ability to access
16 the other is also impaired. For example, the downgrade to junk bond status would
17 adversely affect the Company's ability to access the equity market. Similarly, the
18 inability to access the equity market is considered a negative factor on credit ratings.

19
20 Specifically, the Company's ability to access the equity market would be severely
21 impaired because the Enron Plan would destroy not only PECO Energy's net cash
22 flow (as previously discussed), but also its earnings per share. Analysts' consensus

1 1997 earnings estimate for PECO Energy is approximately \$2.10 and the common
2 stock is currently trading at approximately \$23 per share. Through 2005, the
3 Company's earnings per share would be reduced dramatically, with a loss of \$.22 per
4 share in 1999 and earnings not exceeding \$.97 per share. This projected level of
5 earnings per share would cause a significant drop in the price of the Company's
6 common stock.

7
8 **Q. What would be the effect of the Enron Plan on the interest coverage test of**
9 **PECO Energy's mortgage indenture?**

10 A. PECO Energy would fail the interest coverage test and be unable to issue first
11 mortgage bonds against property additions through 2005.

12
13 **Q. Are there other adverse financial impacts of the Enron Plan on the Company?**

14 A. Yes. The Enron Plan does not reimburse the Company for the costs of issuing the
15 Transition Bonds, the Company's investment in the special purpose subsidiary entity
16 issuing the Transition Bonds ("SPE") or the costs of the Company's use of proceeds
17 in reducing its capitalization. The Company's current estimated costs are \$32 million
18 of issuance expenses, \$27.3 million of equity investment in the SPE and \$504 million
19 of use of proceeds costs. The total cost of \$563.3 million has not been recognized in
20 the Enron Plan and represents a significant additional expense for PECO.

21

1 **Q. Is securitization essential to the success of the Partial Settlement?**

2 A. No. The Partial Settlement provides that if no legal impediment to securitization
3 exists, consumers will receive all of the benefits of the Partial Settlement whether or
4 not PECO Energy ultimately securitizes any portion of its stranded assets. If there is
5 a legal impediment to securitization, the savings to consumers under the Partial
6 Settlement would be reduced by 3%. All of the other benefits to consumers,
7 including the extended rate caps and expansion of the customer assistance plan, would
8 be unaffected.

9
10 **Q. Does the Partial Settlement explain what would be a legal impediment to**
11 **securitization?**

12 A. Yes. The Partial Settlement provides as follows:

13 "For purposes of this settlement, legal impediments shall be
14 deemed to include only those events which would render PECO
15 unable to issue any transition bonds. Such legal impediments
16 shall include statutory changes and state or federal court actions
17 or decisions that preclude securitization. Such preclusion shall
18 be confirmed by an opinion from a qualified and reputable bond
19 counsel. Such legal impediments do not include approvals, if
20 any, required by the Securities and Exchange Commission
21 ("SEC") or the Internal Revenue Service ("IRS") in connection
22 with PECO's securitization. As such, PECO will bear the risk
23 of obtaining any required approvals from the SEC or IRS and
24 will bear the risk that market conditions permit it to securitize
25 its stranded assets and costs on reasonable terms."
26
27

1 **Q. Does this definition differ from Enron's concept of "legal impediment" to the**
2 **issuance of Transition Bonds included by Enron as a condition of the Enron**
3 **Plan?**

4 A. Yes. In Enron's response to Question 5 of Interrogatories, Set II submitted by
5 Senator Vincent J. Fumo, Witness Vorhees answers as follows:

6 "In general, a 'legal impediment' is anything that would impair
7 the marketing and/or issuance of the Transition Bonds."
8
9

10 **Q. What would be the impact of a "legal impediment" on the Enron Plan?**

11 A. As Witness Vorhees states in her answer to Senator Fumo's interrogatory
12 referenced above:

13 "The Choice Plan and the rate reductions provided for therein
14 would not go into effect unless or until the "legal impediment"
15 ceased to impair the marketing and/or issuance of the Transition
16 Bonds."
17

18 **Q. Are you familiar with the lawsuit filed by the Indianapolis Power & Light**
19 **Company against the Pennsylvania Public Utility Commission challenging the**
20 **constitutionality of the Competition Act under the commerce clause of the U.S.**
21 **Constitution?**

22 A. Yes.

23 **Q. Is it your belief that this lawsuit is likely to adversely affect the marketing, or**
24 **constitute a legal impediment to the issuance, of Transition Bonds under the**
25 **Enron Plan?**

26 A. An adverse determination in this lawsuit would preclude the marketing and issuance
27 of the Transition Bonds.

1 **Q. Could Transition Bonds be issued pending resolution of the lawsuit?**

2 A. If the issuer could obtain a "no merit" opinion of reputable, qualified counsel
3 acceptable to the underwriter, security issuance might be possible.

4 **Q. Has Enron provided such an opinion?**

5 A. No, not to my knowledge, and if they had one, I would think that they would be
6 forthcoming with it in order to provide the parties and the Commission comfort that
7 the bonds could actually be issued under their proposal. As I noted previously, the
8 entire Enron proposal is contingent on securitization, so any uncertainty such as the
9 ability to obtain the necessary legal opinions must be carefully scrutinized.

10
11 In contrast, the Partial Settlement is not contingent on the securitization. Rather,
12 under the Partial Settlement, all of the benefits, particularly the rate discounts, flow to
13 customers unless PECO comes forward and demonstrates through "an opinion from
14 qualified and reputable bond counsel" that a legal impediment to securitization exists.
15 And then, the only effect is a 3% reduction in savings to customers.

16
17 **A. SECURITIZATION UNDER THE ENRON PLAN CANNOT BE**
18 **ACCOMPLISHED UNDER THE PECO MORTGAGE**

19
20 **Q. What is the PECO Mortgage?**

21 A. Of the Company's long-term debt, \$3.8 billion, or approximately 90%, are first
22 mortgage bonds issued and secured under the Company's first mortgage indenture —

1 the PECO Mortgage. All of the Company's first mortgage bonds are secured by a
2 lien of the PECO Mortgage, which is a lien on substantially all of the Company's
3 property, except shares of stock, bonds and other securities not specifically pledged.
4

5 **Q. How does the PECO Mortgage relate to the Intangible Transition Property?**

6 A. The PECO Mortgage constitutes a first lien on, among other things, all contract rights
7 held by the Company. The Electricity Generation Customer Choice and Competition
8 Act (the "Competition Act") defines Intangible Transition Property as a "contract
9 right" prior to its sale or transfer. The issuance of Transition Bonds will require the
10 sale or transfer of the Intangible Transition Property. Upon the sale or transfer of the
11 Intangible Transition Property, the Competition Act gives the holders of Transition
12 Bonds a statutory lien superior to all other liens, including the lien of the PECO
13 Mortgage, thereby causing a release of the Intangible Transition Property from the
14 lien of the PECO Mortgage. The PECO Mortgage requires that in connection with
15 the release of property from the lien of the PECO Mortgage, the fair value of the
16 property being released must be deposited with First Union National Bank, the trustee
17 under the PECO Mortgage (the "Mortgage Trustee"). Therefore, in order for PECO
18 Energy to cause the issuance of Transition Bonds without being in violation of the
19 PECO Mortgage, the fair value of the Intangible Transition Property must be
20 deposited with the Mortgage Trustee.
21

1 **Q. If the PECO Mortgage attaches to the Intangible Transition Property, how can it**
2 **be used to secure the Transition Bonds?**

3 A. The PECO Mortgage allows the Company to sell mortgaged property free from the
4 lien of the PECO Mortgage on the property held by the Mortgage Trustee. In order
5 to protect the interest of the first mortgage bondholders, the sale of the mortgaged
6 property by the Company must comply with the specific provisions of the PECO
7 Mortgage and federal securities laws.

8
9 **Q. How will these provisions of the PECO Mortgage apply to the sale of the**
10 **Intangible Transition Property?**

11 A. In order to accomplish a successful securitization, the Company will have to sell the
12 Intangible Transition Property for cash of at least equal value to the Intangible
13 Transition Property and to deposit that cash with the Mortgage Trustee. Pursuant to
14 the express terms of the PECO Mortgage, the release of the lien of the PECO
15 Mortgage on the Intangible Transition Property may occur only if there is a deposit
16 with the Mortgage Trustee of cash of at least equal value to the Intangible Transition
17 Property.

18
19 **Q. Are there any other requirements of the PECO Mortgage which must be satisfied**
20 **in order to release the lien on the Intangible Transition Property?**

21 A. Yes. They are explained in Mr. Rayzis's testimony. These requirements include
22 both a sworn statement of the president or a vice president of the Company and an

1 opinion of an independent engineer, appraiser or other expert that \$5.461 billion, the
2 amount Enron "pays" PECO Energy, equals the value of the Intangible Transition
3 Property.

4
5 **Q. Under the Enron Plan, will the Company be able to meet the conditions of the**
6 **PECO Mortgage necessary to release the lien of the PECO Mortgage on the**
7 **Intangible Transition Property?**

8 A. No. The Company would not be able to meet the two conditions described in my
9 previous answer. Under these circumstances, I could not and would not submit the
10 required certificates for such a release to the Mortgage Trustee.

11
12 **Q. Please explain.**

13 A. As described below and as indicated in Mr. Hiller's testimony and in Mr. Fastow's
14 testimony (page 4-5), under the Enron proposal, the Company would not be selling
15 the Intangible Transition Property for cash of equal value to the Intangible Transition
16 Property because the value being received by PECO Energy is less than the value of
17 the Class A and the Class B Pass-Through Certificates. Because the Company is not
18 receiving equal value, it will not be able to deposit the requisite equal value of the
19 Intangible Transition Property with the Mortgage Trustee. Thus, the Company will
20 not under the terms of the PECO Mortgage be able to allow the release of the lien of
21 the PECO Mortgage on the Intangible Transition Property.

1 **Q. If the Intangible Transition Property remains subject to the lien of the PECO**
2 **Mortgage, will Enron be able to achieve the securitization proposed by the Enron**
3 **Plan?**

4 A. No. As Mr. Hiller explains, in order to accomplish any successful securitization, the
5 underlying property, in this case the Intangible Transition Property, must be released
6 from the lien of the PECO Mortgage.

7
8 **Q. Why doesn't securitization under the Partial Settlement encounter these same**
9 **problems?**

10 A. Only the portion of the Intangible Transition Property represented by the value of the
11 Transition Bonds sold to investors is being sold pursuant to the Partial Settlement.
12 Therefore, PECO Energy will be able to meet the requirements of the PECO
13 Mortgage and justify the necessary release.

14
15 **Q. Are the protections described above unique to the PECO Mortgage?**

16 A. The release provisions requiring the deposit with the Mortgage Trustee of the fair
17 value of the mortgaged property sold in order to release of the lien of the PECO
18 Mortgage are substantially the same as in all utility mortgages. The provisions
19 included in the PECO Mortgage are required by the Trust Indenture Act of 1939 to be
20 included in all secured indentures for public debt.

21

1 **Q. Are there other concerns with the Enron Plan under the PECO Mortgage?**

2 A. Yes. The PECO Mortgage also requires the Company to maintain, subject to certain
3 exceptions, its franchises. The Company is allowed to omit maintaining and
4 preserving a franchise right if, in the opinion of the Company, it is inadvisable to
5 maintain or preserve that right. The Company does not believe that failing to
6 preserve the right to be the provider of last resort would be advisable and any
7 Commission action or voluntary action by the Company forfeiting that right could
8 constitute a default under the PECO Mortgage. In order to avoid that default, the
9 Company would be compelled to contest any such forfeiture imposed by the
10 Commission on the Company. Further, during such a default, the Company would
11 not be allowed to release any property, including Intangible Transition Property, from
12 the lien of the PECO Mortgage, even if the fair value were deposited with the
13 Mortgage Trustee.

14
15 **B. SECURITIZATION UNDER THE ENRON PLAN UNLIKELY TO**
16 **RECEIVE A FAVORABLE IRS PRIVATE LETTER RULING**

17
18 **Q. Has PECO Energy requested a private letter ruling from the Internal Revenue**
19 **Service ("IRS") concerning its securitization plan?**

20 A. Yes, we expect to receive a favorable ruling by the end of November. Receipt of a
21 favorable ruling from the IRS will eliminate all of the material tax risks associated
22 with the transaction.

1 **Q. Is PECO Energy prepared to proceed with the securitization transaction if it does**
2 **not receive a favorable ruling from the IRS?**

3 A. Absolutely not. The risk to the Company would be much too great.
4

5 **Q. Do you think a favorable ruling from the IRS on the Enron securitization plan is**
6 **likely?**

7 A. No. As Mr. Sharpe of Coopers & Lybrand will more fully explain in his testimony,
8 there is a real and substantial likelihood that the IRS would view the transaction as a
9 taxable sale of the Intangible Transition Property and related Intangible Transition
10 Charges by PECO Energy to the grantor trust formed by Enron to hold the Transition
11 Bonds, in which event PECO Energy may be required to include the full \$5.461
12 billion proceeds from the sale of the Transition Bonds in its taxable income at the
13 time the Transition Bonds are sold.
14

15 Mr. Sharpe reviewed the Enron proposal and concluded that it would not receive a
16 favorable ruling from the IRS. As Mr. Sharpe explains, in conducting his tax
17 analysis, he relied upon the results of a cash flow analysis of the Enron securitization
18 proposal that the Company prepared and which is provided as Exhibit No. JBM-9.
19

20 **Q. How was the cash flow analysis prepared?**

21 A. The cash flow analysis compares the cash in-flows from Intangible Transition
22 Charges, at the level projected by Enron, to the cash out-flows necessary to pay

1 principal and interest on Transition Bonds in the aggregate principal amount of \$5.461
2 billion, having a 124 month term and bearing interest at the stated rate of 9.66%. In
3 preparing this analysis, we made the same assumptions that Enron purports to adopt
4 and did not take into consideration delinquencies and charge-offs because, according
5 to Enron, the Electric Generation Suppliers will assume liability for the payment of
6 Intangible Transition Charges on behalf of their generation customers.

7
8 **Q: What will the tax consequences to PECO Energy be if the IRS refuses to issue a**
9 **favorable tax ruling?**

10 A: As Mr. Sharpe will further testify, there is a real and substantial likelihood that the
11 IRS would view the implementation of the Enron Plan as a taxable transaction,
12 thereby exposing PECO Energy to a potential federal and Pennsylvania income tax
13 liability in excess of \$2.250 billion. In contrast, I am quite confident that PECO
14 Energy will receive a favorable ruling from the IRS on its securitization transaction.

15
16 **Q. What impact would the imposition of a tax liability of this magnitude have on**
17 **PECO Energy's credit rating for its indebtedness?**

18 A: We have not performed any financial analysis because the Company would not even
19 consider effecting a securitization transaction without obtaining a favorable tax ruling.
20 The risks of proceeding without a favorable tax ruling are just too great. I am
21 confident, however, that the use of a substantial portion of the proceeds of the

1 Transition Bonds to satisfy tax liabilities instead of reducing stranded costs would
2 only further degrade the Company's financial integrity.

3
4 **C. SECURITIZATION UNDER THE ENRON PLAN VIOLATES THE**
5 **COMPETITION ACT**
6

7 **Q. Does the securitization proposal set forth in the Enron Plan comply with the**
8 **provisions of the Competition Act?**

9 A. No. Enron's securitization plan calls for the issuance of Transition Bonds with a
10 maturity of 124 months (see Direct Testimony of Andrew Fastow — page 12) —
11 which exceeds the maximum 10-year maturity permitted by Section 2812(g) of the
12 Competition Act.

13
14
15 **VI. ENRON IS AN INAPPROPRIATE ENTITY TO BE THE**
16 **PROVIDER OF LAST RESORT**
17

18 **Q. From a financial standpoint, do you believe that Enron is an appropriate entity**
19 **to be the provider of last resort?**

20 A. No. Enron is a special purpose entity with no apparent assets and only three
21 employees. In its present form, it does not have any cash flow or access to the
22 capital markets—in short, it has no financial integrity.

1 Q. How does the Enron Plan attempt to remedy the fact that Enron has no financial
2 integrity?

3 A. The Enron Plan and related testimony claim that Enron will have the necessary
4 contractual arrangements with PECO Energy and "appropriate financial backing" of
5 Enron Corp. to be the provider of last resort.

6
7 Q. Are you familiar with this type of structure?

8 A. Yes, it is a commonplace arrangement known as project financing in which limited
9 financial resources and contractual obligations are aggregated in a special purpose
10 entity and then leveraged to facilitate the financing of an asset such as a non-utility
11 generating facility or large scale power plant developed by an independent power
12 producer. Project finance structures are also often used to keep the special purpose
13 entity's obligations off the parent company's balance sheet. A more important aspect
14 is to create a structure in which the recourse of lenders and others, including
15 customers, is limited to the assets of the special purpose entity. This avoids exposing
16 the assets of the parent company to the risk of the transaction. In other words, in the
17 worst case, if the special purpose entity goes bankrupt, the parent company only loses
18 the assets that the special purpose entity was designed to finance.

19

1 **Q. Do you believe that a project-financed special purpose entity is appropriate as the**
2 **provider of last resort?**

3 A. Absolutely not. A project-financed special purpose entity should not be imported into
4 the public service arena where a broad array of consumers are dependent on that
5 entity for an essential service.

6
7 Before I explain the reasons for this conclusion, let me first emphasize a number of
8 the points from Mr. Hill's testimony. The Company does not believe that the
9 Competition Act authorizes the appointment of a provider of last resort other than the
10 regulated electric distribution company prior to the end of the transition period. Even
11 if the Commission disagrees with this position, the Company does not believe that the
12 Competition Act authorizes an entity which is not a public utility, and thus not subject
13 to regulation by the Commission, to be appointed as the provider of last resort prior
14 to the end of the transition period.

15
16 **Q. Explain why you feel the project-financed special purpose entity proposed in the**
17 **Enron Plan as the provider of last resort is inappropriate.**

18 A. Project finance, which is clearly an accepted financing technique for a specific asset,
19 will not allow the provider of last resort the financial flexibility needed to fulfill its
20 obligation to serve. Enron has conveniently avoided this dilemma by imposing all of
21 its service obligations and unanticipated liabilities on PECO Energy by contract as
22 described in the testimony of Mr. Sundemeir and Mr. Pratzon. Second, project

1 finance entities are typically highly leveraged and as thinly capitalized as the project
2 lenders will permit. Lenders are willing to accept this risk because the purpose of the
3 financing is to finance the specific asset. The special purpose entity contractually
4 obtains all of the necessary resources to construct, operate and manage that asset
5 concurrently with the financing. All of the assets and contracts of the special purpose
6 entity in this case, the contracts with PECO Energy, are then pledged to the lender.
7 Because of the limited assets and high leverage of the special purpose entity, lenders
8 typically require extensive control over the activities of the special purpose entity.
9 This restrictive financial structure and high leverage are not appropriate for an entity
10 which must have the financial integrity to meet its constantly changing obligation to
11 serve.

12
13 **Q. Do you have additional concerns about Enron as the provider of last resort?**

14 **A.** Yes. One of the conditions of the Enron Plan is that Enron, as the provider of last
15 resort, shall not be a public utility. As a result, Enron will not be subject to the
16 financial safeguards imposed by the Public Utility Code on entities which are
17 obligated to serve the public. The Commission will not have authority (i) to regulate
18 the transfer of customers or assets of Enron used or useful in the public service under
19 Chapter 11, (ii) to regulate the issuance of securities by Enron under Chapter 19 or
20 (iii) to regulate affiliated interest transactions of Enron under Chapter 21. All of
21 these safeguards are intended to protect the financial viability of an entity serving the
22 public and will not be applicable to Enron if it is not a public utility.

1 Q. Won't these concerns be overcome by the commitment of Enron Corp. to provide
2 "appropriate financial backing"?

3 A. No. The appropriate level of financial backing will apparently be negotiated between
4 Enron Corp. and the Commission prior to implementation of the Enron Plan. Since
5 Enron will not be a public utility, Enron Corp. will not be an affiliate of a public
6 utility under Chapter 21 of the Public Utility Code and the Commission will have no
7 authority whatsoever over Enron Corp. Thus, the Commission would not have
8 authority to require an increase in "the financial backing" offered by Enron Corp. if
9 necessitated by financial circumstances. In fact, absent a contractual right to enforce
10 the commitments of Enron Corp., the Commission may not be able to assure the
11 initial level of financial backing of Enron Corp. is maintained.

12
13 VII. CONCLUSION

14
15 Q. Does this conclude your testimony?

16 A. Yes.

Ability of ITC to Cover 9.66% Transition Bonds (No Base Load Growth)

Month	ITC	Usage	Collections	0% GRT	Net Collections	Beginning Balance		9.66% Transition Bonds			Period Shortfall (after applic of Subaccts)	Accumulated Shortfall	Interest On Accumulated Shortfall
						50bps Ovrcllrtrzn Subaccount	50bps Capital Subaccount	Interest	Principal	Ending Balance			
							50bps Capital Subaccount						
Sep-98	0.0131	2,797,416,667	18,323,079	0	18,323,079	0	1,667,029	43,961,050	0	5,461,000,000	0		
Oct-98	0.0131	2,797,416,667	36,646,158	0	36,646,158	0	0	43,961,050	0	5,461,000,000	(5,647,863)	(5,647,863)	(45,465)
Nov-98	0.0131	2,797,416,667	36,646,158	0	36,646,158	0	0	43,961,050	0	5,461,000,000	(7,314,892)	(13,008,219)	(104,716)
Dec-98	0.0131	2,797,416,667	36,646,158	0	36,646,158	0	0	43,961,050	0	5,461,000,000	(7,314,892)	(20,427,827)	(164,444)
Jan-99	0.0131	2,797,416,667	36,646,158	0	36,646,158	0	0	43,961,050	0	5,461,000,000	(7,314,892)	(27,907,163)	(224,653)
Feb-99	0.0131	2,797,416,667	36,646,158	0	36,646,158	0	0	43,961,050	0	5,461,000,000	(7,314,892)	(35,446,707)	(285,346)
Mar-99	0.0131	2,797,416,667	36,646,158	0	36,646,158	0	0	43,961,050	0	5,461,000,000	(7,314,892)	(43,046,945)	(346,528)
Apr-99	0.0131	2,797,416,667	36,646,158	0	36,646,158	0	0	43,961,050	0	5,461,000,000	(7,314,892)	(50,708,365)	(408,202)
May-99	0.0131	2,797,416,667	36,646,158	0	36,646,158	0	0	43,961,050	0	5,461,000,000	(7,314,892)	(58,431,459)	(470,377)
Jun-99	0.0131	2,797,416,667	36,646,158	0	36,646,158	0	0	43,961,050	0	5,461,000,000	(7,314,892)	(66,216,723)	(533,045)
Jul-99	0.0131	2,797,416,667	36,646,158	0	36,646,158	0	0	43,961,050	0	5,461,000,000	(7,314,892)	(74,064,660)	(596,221)
Aug-99	0.0131	2,797,416,667	36,646,158	0	36,646,158	0	0	43,961,050	0	5,461,000,000	(7,314,892)	(81,975,772)	(659,905)
Sep-99	0.0131	2,797,416,667	36,646,158	0	36,646,158	0	0	43,961,050	0	5,461,000,000	(7,314,892)	(89,950,569)	(724,102)
Oct-99	0.0131	2,797,416,667	36,646,158	0	36,646,158	0	0	43,961,050	0	5,461,000,000	(7,314,892)	(97,989,562)	(788,816)
Nov-99	0.0131	2,797,416,667	36,646,158	0	36,646,158	0	0	43,961,050	0	5,461,000,000	(7,314,892)	(106,093,270)	(854,051)
Dec-99	0.0131	2,797,416,667	36,646,158	0	36,646,158	0	0	43,961,050	0	5,461,000,000	(7,314,892)	(114,262,212)	(919,811)
Jan-00	0.0131	2,797,416,667	36,646,158	0	36,646,158	0	0	43,961,050	0	5,461,000,000	(7,314,892)	(122,496,915)	(986,100)
Feb-00	0.0131	2,797,416,667	36,646,158	0	36,646,158	0	0	43,961,050	0	5,461,000,000	(7,314,892)	(130,797,907)	(1,052,923)
Mar-00	0.0131	2,797,416,667	36,646,158	0	36,646,158	0	0	43,961,050	0	5,461,000,000	(7,314,892)	(139,165,722)	(1,120,284)
Apr-00	0.0131	2,797,416,667	36,646,158	0	36,646,158	0	0	43,961,050	0	5,461,000,000	(7,314,892)	(147,600,897)	(1,188,187)
May-00	0.0131	2,797,416,667	36,646,158	0	36,646,158	0	0	43,961,050	0	5,461,000,000	(7,314,892)	(156,103,976)	(1,256,637)
Jun-00	0.0131	2,797,416,667	36,646,158	0	36,646,158	0	0	43,961,050	0	5,461,000,000	(7,314,892)	(164,675,505)	(1,325,638)
Jul-00	0.0131	2,797,416,667	36,646,158	0	36,646,158	0	0	43,961,050	0	5,461,000,000	(7,314,892)	(173,316,034)	(1,395,194)
Aug-00	0.0131	2,797,416,667	36,646,158	0	36,646,158	0	0	43,961,050	0	5,461,000,000	(7,314,892)	(182,026,120)	(1,465,310)
Sep-00	0.0131	2,797,416,667	36,646,158	0	36,646,158	0	0	43,961,050	0	5,461,000,000	(7,314,892)	(190,806,322)	(1,535,991)
Oct-00	0.0131	2,797,416,667	36,646,158	0	36,646,158	0	0	43,961,050	0	5,461,000,000	(7,314,892)	(199,657,205)	(1,607,240)
Nov-00	0.0131	2,797,416,667	36,646,158	0	36,646,158	0	0	43,961,050	0	5,461,000,000	(7,314,892)	(208,579,337)	(1,679,064)
Dec-00	0.0131	2,797,416,667	36,646,158	0	36,646,158	0	0	43,961,050	0	5,461,000,000	(7,314,892)	(217,573,292)	(1,751,465)
Jan-01	0.0223	2,797,416,667	50,462,500	0	50,462,500	0	0	43,961,050	6,501,450	5,454,498,550		(219,324,757)	(1,765,564)
Feb-01	0.0223	2,797,416,667	62,382,392	0	62,382,392	0	0	43,908,713	18,473,678	5,436,024,872		(221,090,321)	(1,779,777)
Mar-01	0.0223	2,797,416,667	62,382,392	0	62,382,392	0	0	43,760,000	18,622,391	5,417,402,480		(222,870,098)	(1,794,104)
Apr-01	0.0223	2,797,416,667	62,382,392	0	62,382,392	0	0	43,610,090	18,772,302	5,398,630,179		(224,664,203)	(1,808,544)
May-01	0.0223	2,797,416,667	62,382,392	0	62,382,392	0	0	43,458,973	18,923,419	5,379,706,760		(226,472,750)	(1,823,100)
Jun-01	0.0223	2,797,416,667	62,382,392	0	62,382,392	0	0	43,306,639	19,075,752	5,360,631,008		(228,295,855)	(1,837,782)
Jul-01	0.0223	2,797,416,667	62,382,392	0	62,382,392	0	0	43,153,080	19,229,312	5,341,401,695		(230,133,637)	(1,852,576)
Aug-01	0.0223	2,797,416,667	62,382,392	0	62,382,392	0	0	42,998,284	19,384,108	5,322,017,587		(231,986,213)	(1,867,489)
Sep-01	0.0223	2,797,416,667	62,382,392	0	62,382,392	0	0	42,842,242	19,540,150	5,302,477,437		(233,853,702)	(1,882,522)
Oct-01	0.0223	2,797,416,667	62,382,392	0	62,382,392	0	0	42,684,943	19,697,448	5,282,779,989		(235,736,224)	(1,897,677)
Nov-01	0.0223	2,797,416,667	62,382,392	0	62,382,392	0	0	42,526,379	19,856,013	5,262,923,976		(237,633,900)	(1,912,953)
Dec-01	0.0223	2,797,416,667	62,382,392	0	62,382,392	0	0	42,366,538	20,015,854	5,242,908,123		(239,546,853)	(1,928,352)
Jan-02	0.0277	2,797,416,667	69,935,417	0	69,935,417	0	0	42,205,410	27,730,006	5,215,178,116		(241,475,206)	(1,943,875)
Feb-02	0.0277	2,797,416,667	77,488,442	0	77,488,442	0	0	41,982,184	35,506,258	5,179,671,859		(243,419,081)	(1,959,524)
Mar-02	0.0277	2,797,416,667	77,488,442	0	77,488,442	0	0	41,696,358	35,792,083	5,143,879,775		(245,378,605)	(1,975,298)
Apr-02	0.0277	2,797,416,667	77,488,442	0	77,488,442	0	0	41,408,232	36,080,209	5,107,799,566		(247,353,902)	(1,991,199)
May-02	0.0277	2,797,416,667	77,488,442	0	77,488,442	0	0	41,117,787	36,370,655	5,071,428,911		(249,345,101)	(2,007,228)
Jun-02	0.0277	2,797,416,667	77,488,442	0	77,488,442	0	0	40,825,003	36,663,439	5,034,765,472		(251,352,329)	(2,023,386)
Jul-02	0.0277	2,797,416,667	77,488,442	0	77,488,442	0	0	40,529,862	36,958,580	4,997,806,892		(253,375,716)	(2,039,675)

Ability of ITC to Cover 9.66% Transition Bonds (No Base Load Growth)

Month	ITC	Usage	Collections	0% GRT	Net Collections	Beginning Balance		9.66% Transition Bonds			Period Shortfall (after appplic of Subaccts)	Accumulated Shortfall	Interest On Accumulated Shortfall
						50bps Ovrcltriztn Subaccount	50bps Capital Subaccount	Interest	Principal	Ending Balance			
Aug-02	0.0277	2,797,416,667	77,488,442	0	77,488,442	0	0	40,232,345	37,256,096	4,980,550,796	(255,415,390)	(2,056,094)	
Sep-02	0.0277	2,797,416,667	77,488,442	0	77,488,442	0	0	39,932,434	37,556,008	4,922,994,788	(257,471,484)	(2,072,645)	
Oct-02	0.0277	2,797,416,667	77,488,442	0	77,488,442	0	0	39,630,108	37,858,334	4,885,136,455	(259,544,129)	(2,089,330)	
Nov-02	0.0277	2,797,416,667	77,488,442	0	77,488,442	0	0	39,325,348	38,163,093	4,846,973,361	(261,633,460)	(2,106,149)	
Dec-02	0.0277	2,797,416,667	77,488,442	0	77,488,442	0	0	39,018,136	38,470,306	4,808,503,055	(263,739,609)	(2,123,104)	
Jan-03	0.0311	2,797,416,667	82,244,050	0	82,244,050	0	0	38,708,450	43,535,600	4,764,967,455	(265,862,713)	(2,140,195)	
Feb-03	0.0311	2,797,416,667	86,999,658	0	86,999,658	0	0	38,357,988	48,641,670	4,716,325,785	(268,002,908)	(2,157,423)	
Mar-03	0.0311	2,797,416,667	86,999,658	0	86,999,658	0	0	37,966,423	49,033,236	4,667,292,549	(270,160,331)	(2,174,791)	
Apr-03	0.0311	2,797,416,667	86,999,658	0	86,999,658	0	0	37,571,705	49,427,953	4,617,864,595	(272,335,122)	(2,192,298)	
May-03	0.0311	2,797,416,667	86,999,658	0	86,999,658	0	0	37,173,810	49,825,848	4,568,038,747	(274,527,420)	(2,209,946)	
Jun-03	0.0311	2,797,416,667	86,999,658	0	86,999,658	0	0	36,772,712	50,226,946	4,517,811,801	(276,737,365)	(2,227,736)	
Jul-03	0.0311	2,797,416,667	86,999,658	0	86,999,658	0	0	36,368,385	50,631,273	4,467,180,527	(278,965,101)	(2,245,669)	
Aug-03	0.0311	2,797,416,667	86,999,658	0	86,999,658	0	0	35,960,803	51,038,855	4,416,141,672	(281,210,770)	(2,263,747)	
Sep-03	0.0311	2,797,416,667	86,999,658	0	86,999,658	0	0	35,549,940	51,449,718	4,364,691,940	(283,474,517)	(2,281,970)	
Oct-03	0.0311	2,797,416,667	86,999,658	0	86,999,658	0	0	35,135,770	51,863,888	4,312,828,066	(285,756,487)	(2,300,340)	
Nov-03	0.0311	2,797,416,667	86,999,658	0	86,999,658	0	0	34,718,266	52,281,392	4,260,546,674	(288,056,826)	(2,318,857)	
Dec-03	0.0311	2,797,416,667	86,999,658	0	86,999,658	0	0	34,297,401	52,702,258	4,207,844,416	(290,375,684)	(2,337,524)	
Jan-04	0.0306	2,797,416,667	86,300,304	0	86,300,304	0	0	33,873,148	52,427,157	4,155,417,260	(292,713,208)	(2,356,341)	
Feb-04	0.0306	2,797,416,667	85,600,950	0	85,600,950	0	0	33,451,109	52,149,841	4,103,267,419	(295,069,549)	(2,375,310)	
Mar-04	0.0306	2,797,416,667	85,600,950	0	85,600,950	0	0	33,031,303	52,569,647	4,050,697,771	(297,444,859)	(2,394,431)	
Apr-04	0.0306	2,797,416,667	85,600,950	0	85,600,950	0	0	32,608,117	52,992,833	3,997,704,938	(299,839,290)	(2,413,706)	
May-04	0.0306	2,797,416,667	85,600,950	0	85,600,950	0	0	32,181,525	53,419,425	3,944,285,513	(302,252,997)	(2,433,137)	
Jun-04	0.0306	2,797,416,667	85,600,950	0	85,600,950	0	0	31,751,498	53,849,452	3,890,436,062	(304,686,133)	(2,452,723)	
Jul-04	0.0306	2,797,416,667	85,600,950	0	85,600,950	0	0	31,318,010	54,282,940	3,836,153,122	(307,136,857)	(2,472,468)	
Aug-04	0.0306	2,797,416,667	85,600,950	0	85,600,950	0	0	30,881,033	54,719,917	3,781,433,204	(309,611,324)	(2,492,371)	
Sep-04	0.0306	2,797,416,667	85,600,950	0	85,600,950	0	0	30,440,537	55,160,413	3,726,272,792	(312,103,696)	(2,512,435)	
Oct-04	0.0306	2,797,416,667	85,600,950	0	85,600,950	0	0	29,996,496	55,604,454	3,670,668,338	(314,616,130)	(2,532,660)	
Nov-04	0.0306	2,797,416,667	85,600,950	0	85,600,950	0	0	29,548,880	56,052,070	3,614,616,268	(317,148,790)	(2,553,048)	
Dec-04	0.0306	2,797,416,667	85,600,950	0	85,600,950	0	0	29,097,661	56,503,289	3,558,112,979	(319,701,838)	(2,573,600)	
Jan-05	0.0300	2,797,416,667	84,761,725	0	84,761,725	0	0	28,642,809	56,118,916	3,501,994,063	(322,275,438)	(2,594,317)	
Feb-05	0.0300	2,797,416,667	83,922,500	0	83,922,500	0	0	28,191,052	55,731,448	3,446,262,615	(324,869,755)	(2,615,202)	
Mar-05	0.0300	2,797,416,667	83,922,500	0	83,922,500	0	0	27,742,414	56,180,086	3,390,082,530	(327,484,957)	(2,636,254)	
Apr-05	0.0300	2,797,416,667	83,922,500	0	83,922,500	0	0	27,290,164	56,632,336	3,333,450,194	(330,121,210)	(2,657,476)	
May-05	0.0300	2,797,416,667	83,922,500	0	83,922,500	0	0	26,834,274	57,088,226	3,276,361,968	(332,778,666)	(2,678,868)	
Jun-05	0.0300	2,797,416,667	83,922,500	0	83,922,500	0	0	26,374,714	57,547,786	3,218,814,182	(335,457,555)	(2,700,433)	
Jul-05	0.0300	2,797,416,667	83,922,500	0	83,922,500	0	0	25,911,454	58,011,046	3,160,803,136	(338,157,988)	(2,722,172)	
Aug-05	0.0300	2,797,416,667	83,922,500	0	83,922,500	0	0	25,444,465	58,478,035	3,102,325,101	(340,880,160)	(2,744,085)	
Sep-05	0.0300	2,797,416,667	83,922,500	0	83,922,500	0	0	24,973,717	58,948,783	3,043,376,318	(343,624,245)	(2,766,175)	
Oct-05	0.0300	2,797,416,667	83,922,500	0	83,922,500	0	0	24,499,179	59,423,321	2,983,952,998	(346,390,420)	(2,788,443)	
Nov-05	0.0300	2,797,416,667	83,922,500	0	83,922,500	0	0	24,020,822	59,901,678	2,924,051,319	(349,178,863)	(2,810,890)	
Dec-05	0.0300	2,797,416,667	83,922,500	0	83,922,500	0	0	23,538,613	60,383,887	2,863,667,432	(351,989,753)	(2,833,518)	
Jan-06	0.0344	2,797,416,667	90,076,817	0	90,076,817	0	0	23,052,523	67,024,294	2,796,643,139	(354,823,270)	(2,856,327)	
Feb-06	0.0344	2,797,416,667	96,231,133	0	96,231,133	0	0	22,512,977	73,718,156	2,722,924,983	(357,679,598)	(2,879,321)	
Mar-06	0.0344	2,797,416,667	96,231,133	0	96,231,133	0	0	21,919,546	74,311,587	2,648,613,395	(360,558,919)	(2,902,499)	
Apr-06	0.0344	2,797,416,667	96,231,133	0	96,231,133	0	0	21,321,338	74,909,796	2,573,703,600	(363,461,418)	(2,925,864)	
May-06	0.0344	2,797,416,667	96,231,133	0	96,231,133	0	0	20,718,314	75,512,819	2,498,190,780	(366,387,282)	(2,949,418)	
Jun-06	0.0344	2,797,416,667	96,231,133	0	96,231,133	0	0	20,110,436	76,120,698	2,422,070,083	(369,336,700)	(2,973,160)	

Ability of ITC to Cover 9.66% Transition Bonds (No Base Load Growth)

Month	ITC	Usage	Collections	0% GRT	Net Collections	Beginning Balance		9.66% Transition Bonds			Period Shortfall (after applic of Subacct)	Accumulated Shortfall	Interest On Accumulated Shortfall
						50bps Ovrcltrltzn Subaccount	50bps Capital Subaccount	Interest	Principal	Ending Balance			
Jul-06	0.0344	2,797,416,667	96,231,133	0	96,231,133	0	0	19,497,664	76,733,469	2,345,336,614		(372,309,860)	(2,997,094)
Aug-06	0.0344	2,797,416,667	96,231,133	0	96,231,133	0	0	18,879,960	77,351,174	2,267,985,440		(375,306,955)	(3,021,221)
Sep-06	0.0344	2,797,416,667	96,231,133	0	96,231,133	0	0	18,257,283	77,973,851	2,190,011,590		(378,328,176)	(3,045,542)
Oct-06	0.0344	2,797,416,667	96,231,133	0	96,231,133	0	0	17,629,593	78,601,540	2,111,410,050		(381,373,717)	(3,070,058)
Nov-06	0.0344	2,797,416,667	96,231,133	0	96,231,133	0	0	16,996,851	79,234,282	2,032,175,767		(384,443,776)	(3,094,772)
Dec-06	0.0344	2,797,416,667	96,231,133	0	96,231,133	0	0	16,359,015	79,872,118	1,952,303,649		(387,538,548)	(3,119,685)
Jan-07	0.0388	2,797,416,667	102,385,450	0	102,385,450	0	0	15,716,044	86,669,406	1,865,634,243		(390,658,234)	(3,144,799)
Feb-07	0.0388	2,797,416,667	108,539,767	0	108,539,767	0	0	15,018,356	93,521,411	1,772,112,832		(393,803,032)	(3,170,114)
Mar-07	0.0388	2,797,416,667	108,539,767	0	108,539,767	0	0	14,265,508	94,274,258	1,677,838,574		(396,973,147)	(3,195,634)
Apr-07	0.0388	2,797,416,667	108,539,767	0	108,539,767	0	0	13,506,601	95,033,166	1,582,805,408		(400,168,781)	(3,221,359)
May-07	0.0388	2,797,416,667	108,539,767	0	108,539,767	0	0	12,741,584	95,798,183	1,487,007,224		(403,390,139)	(3,247,291)
Jun-07	0.0388	2,797,416,667	108,539,767	0	108,539,767	0	0	11,970,408	96,569,359	1,390,437,866		(406,637,430)	(3,273,431)
Jul-07	0.0388	2,797,416,667	108,539,767	0	108,539,767	0	0	11,193,025	97,346,742	1,293,091,124		(409,910,861)	(3,299,782)
Aug-07	0.0388	2,797,416,667	108,539,767	0	108,539,767	0	0	10,409,384	98,130,383	1,194,960,741		(413,210,644)	(3,326,346)
Sep-07	0.0388	2,797,416,667	108,539,767	0	108,539,767	0	0	9,619,434	98,920,333	1,096,040,408		(416,536,989)	(3,353,123)
Oct-07	0.0388	2,797,416,667	108,539,767	0	108,539,767	0	0	8,823,125	99,716,641	996,323,767		(419,890,112)	(3,380,115)
Nov-07	0.0388	2,797,416,667	108,539,767	0	108,539,767	0	0	8,020,406	100,519,360	895,804,407		(423,270,228)	(3,407,325)
Dec-07	0.0388	2,797,416,667	108,539,767	0	108,539,767	0	0	7,211,225	101,328,541	794,475,865		(426,677,553)	(3,434,754)
Jan-08	0.0383	2,797,416,667	107,840,413	0	107,840,413	0	0	6,395,531	101,444,882	693,030,984		(430,112,307)	(3,462,404)
Feb-08	0.0383	2,797,416,667	107,141,058	0	107,141,058	0	0	5,578,899	101,562,159	591,468,825		(433,574,711)	(3,490,276)
Mar-08	0.0383	2,797,416,667	107,141,058	0	107,141,058	0	0	4,761,324	102,379,734	489,089,090		(437,064,988)	(3,518,373)
Apr-08	0.0383	2,797,416,667	107,141,058	0	107,141,058	0	0	3,937,167	103,203,891	385,885,199		(440,583,361)	(3,546,696)
May-08	0.0383	2,797,416,667	107,141,058	0	107,141,058	0	0	3,106,376	104,034,682	281,850,517		(444,130,057)	(3,575,247)
Jun-08	0.0383	2,797,416,667	107,141,058	0	107,141,058	0	0	2,268,897	104,872,162	176,978,355		(447,705,304)	(3,604,028)
Jul-08	0.0383	2,797,416,667	107,141,058	0	107,141,058	0	0	1,424,676	105,716,383	71,261,972		(451,309,332)	(3,633,040)
Aug-08	0.0383	2,797,416,667	107,141,058	0	107,141,058	0	0	573,659	106,567,399	(35,305,427)		(454,942,372)	(3,662,286)
Sep-08	0.0383	2,797,416,667	107,141,058	0	107,141,058	0	0	(284,209)	107,425,267	(142,730,694)		(458,604,658)	(3,691,767)
Oct-08	0.0383	2,797,416,667	107,141,058	0	107,141,058	0	0	(1,148,982)	108,290,040	(251,020,734)		(462,296,425)	(3,721,466)
Nov-08	0.0383	2,797,416,667	107,141,058	0	107,141,058	0	0	(2,020,717)	109,161,775	(360,182,510)		(466,017,911)	(3,751,444)
Dec-08	0.0383	2,797,416,667	107,141,058	0	107,141,058	0	0	(2,899,469)	110,040,528	(470,223,037)		(469,769,356)	(3,781,643)
Jan-09	0.0383	1,398,708,333	53,570,529	0	53,570,529	0	0		53,570,529	(523,793,566)		(473,550,999)	

R-00973953, R00973953C001
PECO Statement No. 20-ERJ C0007
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BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

APPLICATION OF PECO ENERGY COMPANY
FOR APPROVAL OF ITS RESTRUCTURING PLAN
UNDER SECTION 2806 OF THE PUBLIC UTILITY CODE

REJOINDER TESTIMONY

OF

J. BARRY MITCHELL

REGARDING THE ENRON CHOICE PLAN

Regarding the Petition of
Enron Energy Service Power, Inc.
for Approval of Enron's "Choice Plan"

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Exhibit JBM-7: The text of this Exhibit will be provided separately
subject to a Confidentiality Agreement

Exhibit JBM-8: Referenced pages from Preliminary Prospectus dated
November 10, 1997, SCE Funding LLC

REJOINDER TESTIMONY OF J. BARRY MITCHELL**I. QUALIFICATIONS**

1
2
3
4 **Q. Please state your name and business address.**

5 A. J. Barry Mitchell, 2301 Market Street, Philadelphia, Pennsylvania.
6

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

8 A. I am the Vice President of Finance and Treasurer of PECO Energy Company ("PECO
9 Energy" or the "Company").
10

11 **Q. Have you testified before in this proceeding?**

12 A. Yes, I submitted Rebuttal Testimony concerning PECO Energy's financial integrity
13 under the intervenors' disallowance proposals and I also submitted testimony
14 concerning PECO Energy's financial integrity and securitization under the Choice
15 Plan (the "Enron Plan") submitted by Enron Energy Services Power, Inc. ("Enron")
16 in this proceeding, Docket R-00973953. I also testified earlier this year in PECO
17 Energy's securitization proceeding regarding PECO Energy's proposal for issuance of
18 Transition Bonds and use of proceeds before the Pennsylvania Public Utility
19 Commission (the "Commission"), Docket R-00973877.
20

1 **II. PURPOSE OF TESTIMONY AND SUMMARY OF CONCLUSIONS**

2
3 **Q. What is the purpose of your testimony?**

4 A. The overall purpose of my testimony is to respond to the rebuttal testimony of Ms.
5 Voorhees and Messrs. Fastow, Kean and Kinney. I will confirm the catastrophic
6 effect of the Enron Plan on the Company's financial integrity. I will describe how
7 the Enron Plan with the proposed modifications ("Enron Plan #2") submitted by Ms.
8 Voorhees and Messrs. Kean and Fastow in their rebuttal testimony further imperils
9 the Company's financial integrity. Finally, I will describe how the modifications to
10 the securitization proposal described in Enron Plan #2 do not cure the fatal flaws in
11 Enron's securitization proposal.

12
13 **Q. Please summarize your conclusions.**

14 A. First, we disagree with the financial analysis in Mr. Kinney's rebuttal testimony.
15
16 Second, Enron Plan #2 would cause increased deterioration of the Company's
17 financial integrity. By requiring the Company to reduce transmission and distribution
18 rates, to use Transition Bond proceeds to repay low-cost debt and by subjecting the
19 Company to interest rate risk on the Transition Bonds, Enron Plan #2 makes the
20 Company's financial integrity described in my prior testimony worse, not better. Mr.
21 Fastow's disingenuous assertion that the receipt of \$5.461 billion of Transition Bond

1 proceeds will cure all of the Company's financial problems fails to recognize that
2 those proceeds will be used to reduce capitalization.

3
4 Third, the securitization proposal described in Enron Plan #2 is still not achievable.
5 Therefore, Enron Plan #2 will not provide the savings to consumers promised by
6 Enron.

7
8 **Q. Do you have any other general responses to the rebuttal testimony you mentioned
9 or to Enron Plan #2?**

10 **A. Yes.** In its October 7, 1997 Petition, Enron promised to pay PECO for stranded
11 assets as agreed to by the Company in the Partial Settlement. This negotiated amount
12 represents a substantial concession - \$2 billion - by PECO from its claimed stranded
13 assets. As I demonstrated in my prior testimony, Enron's promise to pay is illusory -
14 because it is totally contingent on an unachievable securitization. Enron's
15 modifications of the Enron Plan are a clear admission by Enron that it cannot assure
16 the delivery of that payment. Under its contingency plan, Enron now asks the
17 Commission to approve a portion of the Enron Plan without any payment by Enron.

18
19 **III. MR. KINNEY'S FINANCIAL ANALYSIS IS INCORRECT**

20
21 **Q. Have you examined the rebuttal testimony of Mr. Kinney?**

22 **A. Yes,** and I strongly disagree with his conclusion.

1 Q. Please explain.

2 A. As the table on page 8 of my testimony on the Enron Plan shows, the differences
3 between the results of Mr. Kinney's analysis and mine are not small, incremental
4 differences, but differences of several orders of magnitude. We have tried to
5 reproduce Mr. Kinney's results and have decided that the only way to approach them
6 is not to reflect the 20% rate reduction of the Enron Plan. This represents such a
7 fundamental error in the calculations that it is hard to believe a professional of Mr.
8 Kinney's experience would make it, but it is the only way we could approximate his
9 results given the parameters of Enron Plan #2.

10
11 Q. Are the forecasted bond ratings presented in your earlier testimony based only on
12 quantitative analysis and not on any qualitative analysis as Mr. Kinney claims?

13 A. No. The forecasted ratings incorporate both quantitative and qualitative analyses and
14 are based on the specific methodology (Exhibit JBM-2) used by Standard & Poor's
15 ("S&P") from Fall 1993 until Spring 1997. In May 1997, that methodology was
16 expanded to include an analysis specific to foreign utility companies as well as to
17 account for the specific levels of risk of U.S.-based utility companies' operations in
18 generation, transmission and distribution businesses, given the advent of deregulation
19 in the generation business.

20
21 In fact, the original methodology also recognized the fact that "quantitative measures
22 are viewed in the context of a firm's business risk profile" and incorporated the fact

1 that "the credit analysis of utilities is quickly evolving, as utilities are treated less as
2 regulated monopolies and more as entities faced with a host of challengers in a
3 competitive market."

4
5 The May 1997 enhancement to S&P's methodology was of little consequence to U.S.-
6 based utility companies. No ratings of U.S.-based integrated utilities changed due to
7 the May 1997 augmentation of S&P's methodology.

8
9 Therefore, the development of the S&P measures and the analyses resulting in the
10 projections of the Company's mortgage bond ratings are totally consistent with the
11 current S&P philosophy and methodology.

12
13 **Q. Do you have any other comments on Mr. Kinney's testimony?**

14 **A.** Yes. If Mr. Kinney is an expert in financial analysis, I do not understand how he can
15 claim to have had insufficient information and time to evaluate my prior testimony.
16 PECO is a public company. Its annual and quarterly financial statements are publicly
17 available. We also periodically update the financial community on developments,
18 including my July and November testimony. There are over 100 analysts who cover
19 PECO Energy in some fashion. In fact, Chase Securities is one of 34 firms
20 specifically listed in Nelson Publications as having coverage of PECO Energy
21 Company. Finally, what is particularly disturbing is that, regardless of the eleventh
22 hour conclusions drawn by Mr. Kinney, Enron obviously gave no consideration

1 whatsoever to the financial impact of the Choice Plan on PECO Energy - as
2 evidenced by the complete lack of financial analysis. Enron should have taken into
3 account the financial impact of the Enron Plan on PECO Energy before submitting the
4 Enron Plan since all of the customer services for which Enron would be responsible
5 as the provider of last resort are dependent on PECO Energy.

6
7 **Q. What about Mr. Kinney's claim that without certain assumptions, he cannot**
8 **adequately evaluate your prior testimony?**

9 A. Enron was provided with those assumptions on November 11, 1997 (and I am
10 providing them again as Exhibit JBM-7 to this testimony). The assumptions in
11 Exhibit JBM-7 are substantially the same as the assumptions provided to Enron on
12 September 25, 1997.

13
14 **IV. EFFECT OF ENRON PLAN #2 ON THE COMPANY'S**
15 **FINANCIAL INTEGRITY**

16
17 **Q. Have you calculated the effect of the modified Enron Plan #2 on PECO Energy's**
18 **financial integrity?**

19 A. Yes. We have considered two cases in which PECO Energy would issue \$5.461
20 billion of Transition Bonds on September 30, 1998. In both cases, we have assumed
21 the revised transmission and distribution rates and Intangible Transition Charges and
22 generation credits proposed by Enron. In the first case, the proceeds of the

1 Transition Bonds are used to reduce the Company's capitalization in proportion to the
2 Company's existing capitalization. In the second case, the Transition Bond proceeds
3 are used to defease the PECO Mortgage and reduce common and preferred equity.
4 As these analyses will demonstrate, the financial impact on PECO Energy is not
5 ameliorated by the "cash payment" of bond proceeds as Enron Plan #2 suggests.
6

7 **Q. Please summarize those effects.**

- 8 A. • The negative impact of Enron Plan #2 on the Company's financial integrity is
9 even worse than the original Enron Plan.
- 10
- 11 • Under both scenarios, Enron Plan #2 would result in significant downgrading
12 of the Company's mortgage bond rating to junk bond status through 2005. As
13 I have said before, with a junk bond rating at the levels projected, the
14 Company's access to the debt market would be seriously constrained and that
15 access, to the extent available, would come at significantly increased cost.
- 16
- 17 • Under the first scenario, the Company would experience a negative net cash
18 flow of \$944 million in 1999 and a cumulative negative net cash flow of
19 approximately \$4.3 billion through 2005. Under the second scenario, net cash
20 flow is negative \$657 million in 1999 and cumulative cash flow through 2005
21 is negative \$3.8 billion. Under both scenarios, the Company would have
22 insufficient internally generated funds to make capital expenditures, to

1 maintain, improve or upgrade existing generation, transmission and
2 distribution facilities or to respond to technological or other advances that
3 might enhance the system for consumers.

- 4
- 5 • Under both scenarios, earnings per share would show a loss through the entire
6 period from 1999 to 2005. In addition, in the second case, the Company
7 would have earnings per share of only \$0.10 in 1998 as a result of the
8 prepayment of interest and premium necessary to defease the mortgage bonds.
9
- 10 • Again, under either of these scenarios, I expect that the price of the
11 Company's common stock would drop significantly.
12

13 **Q. In your previous testimony, you used the S&P measures to project the**
14 **Company's mortgage bond rating. Can you show the results of Enron Plan #2 on**
15 **the S&P measures?**

16 A. Table JBM-1 provides the pro forma results for the key S&P measures and a
17 projected mortgage bond rating associated with those results for the first scenario I
18 described. Table JBM-2 provides the pro forma results for the second scenario.
19 These are pro forma results showing our assessment of where the values of the S&P
20 measures derived from the Enron Plan #2 would place us with respect to the rating
21 criteria.

TABLE JBM-1

Effects of Enron Plan #2 on Key Financial Criteria

Securitization 9/98 without defeasance of First Mortgage Bonds

	1999	2000	2001	2002	2003	2004	2005
Funds from Operations/ Average Total Debt	4.8%	5.4%	5.2%	3.7%	2.7%	2.4%	2.0%
Funds from Operations/ Interest Coverage	1.65x	1.63x	1.61x	1.45x	1.34x	1.30x	1.25x
Total Debt/Total Capital	62.3%	70.1%	76.1%	82.3%	88.4%	94.0%	99.7%
Pre-Tax Interest Coverage	-0.65x	0.01x	0.59x	0.57x	0.56x	0.58x	0.54x
Net Cash Flow/Capital Expenditures	-21.4%	-12.8%	-7.6%	-16.1%	-21.4%	-20.8%	-23.8%
Projected Bond Rating	B or below						

TABLE JBM-2

Effects of Enron Plan #2 on Key Financial Criteria

Securitization 9/98 with defeasance of First Mortgage Bonds

	1999	2000	2001	2002	2003	2004	2005
Funds from Operations/ Average Total Debt	10.7%	10.8%	9.5%	6.5%	4.7%	4.2%	3.3%
Funds from Operations/ Interest Coverage	2.13x	2.11x	2.01x	1.70x	1.52x	1.48x	1.39x
Total Debt/Total Capital	39.0%	47.9%	55.1%	62.8%	70.5%	77.6%	84.6%
Pre-Tax Interest Coverage	-0.82x	0.07x	0.82x	0.74x	0.69x	0.71x	0.65x
Net Cash Flow/Capital Expenditures	-33.5%	-23.5%	-16.9%	-26.8%	-32.4%	-30.8%	-34.4%
Projected Bond Rating	BB or below	BB or below	B or below				

1 Q. What impact on the Company's bond rating would you expect from these changes
2 to the key bond measures?

3 A. Once again, under both scenarios of Enron Plan #2, I would expect the Company's
4 bond rating to be downgraded from its current investment grade rating of BBB+ to
5 below investment grade, or junk bond status, where it would remain through 2005.
6

7 Q. How would such a rating impact the Company?

8 A. In my previous testimony I specified the effect of a junk bond rating on the
9 Company's access to debt and equity markets and its effect on existing credit
10 facilities. I also described the effect of such a rating on the Company's ability to
11 obtain bank financing. There is no need to repeat all that. The effects of a junk bond
12 rating for one plan are the same as the effects of a junk bond rating for another plan.
13

1 increase. This increase would further adversely impact the Company's financial
2 integrity. In addition, the increase needed in the Intangible Transition Charges to
3 support a higher rate on the Transition Bonds would be offset by a decrease in the
4 generation credit payable to PECO Energy under the Power Purchase Agreement. As
5 a result, PECO Energy will bear a portion of the interest rate risk for Enron's delay
6 in fulfilling its promise to pay PECO Energy for stranded assets.

7
8 **Q. Does Enron Plan #2 add any factors that release Enron from its obligations if
9 securitization is not achieved?**

10 **A.** Yes. Mr. Kean's rebuttal testimony on pages 39 and 40 recites a number of "new"
11 conditions, under the guise of eliminating old ones. Among others, number 4 states
12 that "no change shall have occurred in the business, financial position or prospects of
13 PECO prior to the effective date of the Choice Plan." Number 5 purports to remove
14 the "legal impediment" condition, but in fact just postpones Enron's obligation to pay
15 PECO for stranded assets to December 31, 2000, if at all.

1
2 **A. SECURITIZATION UNDER ENRON PLAN #2 CANNOT BE**
3 **ACCOMPLISHED UNDER THE PECO MORTGAGE**
4

5 **Q. How does Enron Plan #2 deal with your previous testimony that securitization**
6 **cannot be accomplished under the PECO Mortgage?**

7 A. Mr. Fastow's rebuttal testimony (page 5, lines 4-10) implies that the "non-cash value"
8 Enron is supposedly providing would constitute "other property" under the PECO
9 Mortgage and satisfy the condition of paying "fair and equal value" needed for the
10 release of the ITP from the PECO Mortgage. Mr. Fastow and his counsel
11 conveniently ignore the requirement of the PECO Mortgage that this "other property"
12 must be pledged to the Mortgage Trustee so that it can be subject to the lien of the
13 PECO Mortgage for the benefit of the bondholders.

14
15 None of the "non-cash value" described by Mr. Fastow accrues to PECO Energy.
16 Thus, it can't be pledged by PECO Energy to the Mortgage Trustee for the benefit of
17 the mortgage bondholders. Therefore, there is no "other property" under Enron Plan
18 #2 that cures the mortgage problem.

19
20 **Q. Doesn't Mr. Fastow also suggest that PECO Energy defease the Mortgage Bonds**
21 **in order to release the Intangible Transition Property?**

1 A. Yes he does. We have examined the provisions of the PECO Mortgage and have
2 concluded that a legal defeasance would theoretically be possible.
3

4 **Q. What would be required for a legal defeasance of the PECO Mortgage?**

5 A. Prior to the sale of the Intangible Transition Property, the Company would have to
6 deposit with the Mortgage Trustee an amount sufficient to pay all of the principal,
7 premium and interest on the mortgage bonds to the earlier of their first call date or
8 maturity. This would require the deposit with the Mortgage Trustee of approximately
9 \$4.08 billion¹ to defease \$3.5 billion of Mortgage Bonds.
10

11 **Q. Do you believe that the defeasance "solution" suggested by Mr. Fastow is**
12 **workable?**

13 A. No, it only creates new problems.
14

15 **Q. Please explain.**

16 A. A legal defeasance would result in the Company prepaying \$3.5 billion of its lowest
17 cost capital and \$545 million of premium and of interest. As I described previously
18 on page 9, this forced recapitalization of the Company would still have disastrous
19 consequences for the Company's financial integrity. Second, I have been advised by
20 my counsel that the deposit with the Mortgage Trustee required for a legal defeasance
21 would be considered a taxable exchange by bondholders.

22 1 Assuming a defeasance on September 1, 1998.

1 Q. Do you have any other comments on Mr. Fastow's testimony concerning the
2 PECO Mortgage?

3 A. Yes. I want to assure Mr. Fastow and our bondholders that the Company is not using
4 compliance with its contractual obligations under the PECO Mortgage, which has
5 been in effect since 1923, as a "tactical obstacle" to either Enron Plan.
6

7 **B. SECURITIZATION UNDER ENRON PLAN #2 UNLIKELY TO**
8 **RECEIVE A FAVORABLE IRS PRIVATE LETTER RULING**
9

10 Q. Will Enron Plan #2 receive a favorable tax ruling from the Internal Revenue
11 Service ("IRS")?

12 A. Mr. Sharpe has informed me that he is doubtful that Enron Plan #2 would receive a
13 favorable tax ruling. As I stated in my previous testimony, without a favorable tax
14 ruling, the securitization is not achievable.
15

16 **C. SECURITIZATION UNDER ENRON PLAN #2 NOT ACHIEVABLE**
17 **BECAUSE OF LEGAL IMPEDIMENTS**
18

19 Q. Why do legal impediments still prevent securitization under Enron Plan #2?

20 A. Assuming everything else suggested by Enron Plan #2 works or can be made to work
21 by further modifications, the "legal impediments" issue is a real issue and cannot be
22 glossed over as the rebuttal testimony tries to do.

1 Ms. Voorhees suggests in her rebuttal testimony on page 2, lines 16-20 that the
2 answer to the "problem" of pending litigation is for the Transition Bonds to "contain
3 other provisions required by the market to address the effect of potential legal
4 challenges, as is being clarified in pending transactions by California utilities."
5 Typically, she never states exactly what she means, or offers any explanation. By
6 looking at the recently released preliminary prospectus for one of the transactions
7 contemplated in California, we were able to determine that the solution she appears to
8 propose is to deal with the effect of litigation in a representation by the selling utility
9 of the intangible transition property (in this case PECO Energy). An adverse
10 determination by a court in pending litigation would constitute a breach of that
11 representation, triggering an obligation of the selling utility to "buy back" the
12 intangible transition property and, in effect, the bonds. I have included the
13 description of these provisions from the "Risk Factors" and "Description of the
14 Transition Property" sections of that prospectus, dated November 10, 1997 as Exhibit
15 JBM-8.

16
17 This solution may work in California, because the California utilities have securitized
18 only a portion of their stranded costs and may have the financial wherewithal to make
19 the repurchase obligation credible to rating agencies and transition bondholders. As a
20 result of the devastating impact of the Enron Plan on the Company's financial
21 integrity, PECO Energy's repurchase obligation would be meaningless.
22

1
2
3 **VI. CONCLUSION**

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

5 **A. Yes. In conclusion I would like to say that the amount of securitization substantially**
6 **impacts the Company's future financial condition. The Competition Act recognizes**
7 **this fact by explicitly providing the Company with the ability to decide whether to**
8 **issue transition bonds and as to the specific application of the proceeds of transition**
9 **bonds. The first Enron Plan deprives the Company of its statutory right to decide**
10 **whether to issue transition bonds. Enron Plan #2 goes one step further by requiring**
11 **the Company to use the proceeds of the transition bonds in an uneconomic manner.**

12 **Enron must be aware of the dire financial consequences it is attempting to impose on**
13 **PECO Energy. I can only conclude that it does so with total disregard of consumers**
14 **and with the specific intention of financially crippling a potential competitor.**

1

2

3

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5

6 The text of this Exhibit will be provided separately subject to a confidentiality agreement.

7



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November 11, 1997

By Fax and US Mail

Bruce Miller, Esquire
LeBoeuf, Lamb, Greene & MacRae
125 West 55th Street
New York, NY 10019-5389

Re: Application Of PECO Energy Company For Approval Of Its Restructuring Plan
Under Section 2806 Of The Public Utility Code;
Docket No. R-00973953
Petition of Enron Energy Service Power, Inc.; Docket No. P-00971265

Dear Bruce:

Attached is the backup information and underlying assumptions to Mr. Mitchell's testimony that you first requested during our telephone conversation yesterday afternoon and that is the subject of your Motion For an Expedited Ruling To Compel PECO To Produce Workpapers. This information is being provided subject to the Confidentiality Agreement that PECO and Enron have previously entered into regarding discovery. This information supplements the financial information that was provided to your client (through Mr. Clearfield) on September 25th and September 26th, 1997.

Sincerely,

Paul Bonney

PRB/mbo

Attachments

cc: w/attachments
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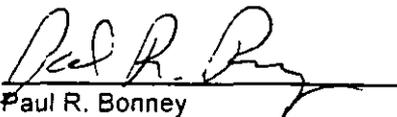
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Dated: November 11, 1997

Certificate of Service

I hereby certify that I have this day served the foregoing document on the following in the matter of Pennsylvania Public Utility Commission v. PECO Energy Company Pa. PUC Docket No. R-00973953.

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PECO Energy Company
Assumptions Used in
Analyzing the Enron Proposal

Revenue

Electric

- Base -- 1996 proforma (weather adjusted) sales
- Existing bundled tariff rates
- Unbundling 9/1/98 per Enron Proposal
 - Distribution - 2.64¢
 - Transmission - 0.47¢
 - CTC - 0
 - ITC - Enron Schedule
 - Market Price - PHB, but not to exceed
Enron Schedule
- Gross receipts tax @ 4.4%
- Sales growth - 0% per year
- Bulk power revenue – based upon market price (confidential)

Gas

- Sales @ 1996 level plus 1.9%/year growth
- Average rate of \$7.50/Mcf
- Transportation constant at \$28 million

Other Revenue

- Assumed constant at \$70 million/year
- Adjustment to LILR consistent with PECC-R-9

PECO Energy Company
Assumptions Used in
Analyzing the Enron Proposal

Fuel Expense

- Fuel per PHB model run
- PHB cost is based upon DRI's forecast
- Purchased power at market rates (confidential)
- Purchased gas cost – increases with sales and general inflation

O&M Expense

- 1996 proforma level is the base (see attachment for adjustments)
- Escalated based upon inflation
 - General rate of inflation of 3%
- Adjustment to customer accounts expense consistent with PECC-R-9.

Other Taxes (Non-income)

- Assumed constant due to RNR adjustment
- GRT changes with revenue for gas
 - 5.0% for gas

Income Taxes

- Statutory rate at 41.3%

Depreciation

- 1996 proforma condition is the base
 - Assumes current regulatory asset amortization per Exhibit ABC-1, sch. 6 (attached)
- Additions at an average life of 35 years
- Market value of generation recovered over 25 years
- Securitization of \$5.461 billion of stranded cost

PECO Energy Company
Assumptions Used in
Analyzing the Enron Proposal

Depreciation (continued)

- Decommissioning Expense
 - Nuclear – per Settlement and Exhibit ABC-4
 - Fossil – per Settlement and Exhibit ABC-5 (see attached)

Investment Tax Credit Amortization

- No change

Capital Expenditures

- Annual level of \$333 million for utility operations
- Increases to \$373 million in 2004 and holds constant
- Assume average 35-year life for plant additions

Interest

- 1996 base level adjusted for maturities and securitization
- Maturities provided in attachment
- Incremental cost of debt is 7.8%

Preferred Dividends

- 1996 level adjusted for maturities and securitization
- Maturities provided in attachment
- New cost of preferred is 7.3%

Other Assumptions

- SFAS 109 deferred tax and regulatory asset amortization impacts income statement.

PECO Energy Company
Assumptions Used in
Analyzing the Enron Proposal

Securitization

- \$5.4 billion of stranded investment securitized:
 - 10 1/3 year transition bonds issued at 9.66%
 - Bonds issued 9/1/98
- \$5.4 billion of securitized funds used in 1998 as follows:
 - First apply to cost of issuance and cost of use of proceeds
 - \$2.5 billion of debt retired (50% of funds targeting most economic issues)
 - \$0.2 billion of preferred repurchased (5% of funds)
 - \$2.2 billion of common equity repurchased (45% of funds)
 - Shares repurchased at market price plus premium
(premium is confidential)
- Current dividend is \$1.80 share

PECO Energy Company
Assumptions Used in
Analyzing the Enron Proposal

Attachments

1. Fossil Decommissioning
2. Regulatory Asset Amortization
- 3,4. Data from 1996 annual report on sales and purchases
5. 1996 Consolidated Income Statement
6. Sales for resale revenue
7. Purchased power expense
- 8-11. Proforma adjustments
12. Debt maturities
13. Preferred maturities

**PECO Energy Company
Fossil Decommissioning Cost Estimates
as of December 31, 1998**

Fossil Plant	Date Installed (1)	Terminal Date (2)	Net Cap MW Summer	Type of Fuel	Years from		Portion Accrued Ratio (5) = (3)/(4)	Decom Cost (a) (\$1,000) (6)	Cost Portion Accrued (\$1,000) (7) = (5)*(6)	Cost From Market (\$1,000) (8) = (6) - (7)	Est Ann. Accrual (\$1,000) (9) = (8)/((4)-(3))
					Inst Date to Collect Date (3) = 1999 - (1)	Inst Date to Terminal Date (4) = (2) - (1)					
CONEMAUGH 1	1970	2005	176	COAL	29	35	0.82857143	\$ 8,983	\$ 7,443	\$ 1,540	\$ 257
CONEMAUGH 2	1971	2008	176	COAL	28	35	0.8	\$ 12,638	\$ 10,111	\$ 2,528	\$ 361
CROMBY 1	1954	2004	144	COAL	45	50	0.9	\$ 9,584	\$ 8,626	\$ 958	\$ 192
CROMBY 2	1955	1999	201	OIL	44	44	1	\$ 15,162	\$ 15,162	\$ -	\$ -
DELAWARE 7	1953	1999	128	OIL	46	46	1	\$ 8,663	\$ 8,663	\$ -	\$ -
DELAWARE 8	1953	1999	124	OIL	46	46	1	\$ 8,663	\$ 8,663	\$ -	\$ -
EDDY 1	1960	2010	279	COAL	39	50	0.78	\$ 15,929	\$ 12,425	\$ 3,504	\$ 319
EDDY 2	1960	2010	302	COAL	39	50	0.78	\$ 15,929	\$ 12,425	\$ 3,504	\$ 319
EDDY 3	1974	2009	380	OIL	25	35	0.71428571	\$ 12,441	\$ 8,887	\$ 3,555	\$ 355
EDDY 4	1976	2011	380	OIL	23	35	0.65714286	\$ 12,441	\$ 8,176	\$ 4,266	\$ 355
KEYSTONE 1	1967	2002	179	COAL	32	35	0.91428571	\$ 9,131	\$ 8,348	\$ 783	\$ 261
KEYSTONE 2	1968	2003	178	COAL	31	35	0.88571429	\$ 13,234	\$ 11,722	\$ 1,513	\$ 378
SCHUYLKILL	1958	1999	168	OIL	41	41	1	\$ 9,958	\$ 9,958	\$ -	\$ -

\$148,755 \$126,605 \$ 22,150

(a) based upon a study prepared by TLO Associates, refer to Schedule 5, page 2 for development of 1998 costs

↑
amortized
in stranded
cost

02-20-01
657

PECO Energy Company
Estimated Balance of Regulatory Assets
as of December 31, 1998
(\$1000)

Description	Balance @ 12/31/96 (1)	1997 Amortization (2)	1998 Amortization (3)	Estimated Balance @ 12/31/98 (4) = (1)-(2)-(3)
CC on 50% Limerick Common	\$ 227,904	\$ 26,046	\$ 26,046	\$ 175,812
Unamortized Loss on Reacq Debt	\$ 190,152	\$ 16,670	\$ 15,172	\$ 153,311
Nuclear Design Basis Document	\$ 31,885	\$ 1,517	\$ 1,517	\$ 28,852
PB/Lim Water Chemistry System	\$ 7,520	\$ 414	\$ 414	\$ 6,692
Limerick 1 Declaratory Order	\$ 45,729	\$ 13,714	\$ 13,714	\$ 19,301
Limerick 2 Declaratory Order	\$ 88,129	\$ 10,072	\$ 10,072	\$ 67,985
SFAS No. 106 (a)	\$ 114,947	\$ 7,184	\$ 7,184	\$ 100,580
SFAS No. 109 (b)	\$ 1,919,352	\$ 114,484	\$ 117,799	\$ 1,687,069
Compensated Absences (a)	\$ 18,430	\$ 921	\$ 921	\$ 16,587
CC on 50% Comm PS/Sal/Eddy	\$ 19,272	\$ 936	\$ 936	\$ 17,400
Sub-Total Regulatory Assets	\$ 2,663,321	\$ 191,957	\$ 193,775	\$ 2,277,589
Electric Fuel Deferral 1996	\$ 92,021	\$ -	\$ -	\$ 109,330
Additional Fuel Deferral	\$ 198,000	\$ -	\$ -	\$ 202,138
Regulatory Assets	\$ 2,953,342			\$ 2,589,057

NOTE: All balances are generation portion only.

(a) Refer to Schedule 6, page 2 for 12/31/96 balance.

(b) Refer to Schedule 6, page 3 for development of annual amortization.

Operating Revenue	\$2,354,326	\$2,775,325	\$2,624,797	\$2,605,425	\$2,597,141	\$2,662,573	\$2,729,405
Operating Expenses							
Fuel and Interchange	772,316	568,493	501,451	482,073	548,546	606,182	737,259
Operation	886,580	877,289	1,108,773	737,715	843,566	781,442	533,374
Maintenance	310,750	292,468	313,025	248,095	327,644	316,309	250,818
Total Operation and Maintenance	1,969,756	1,738,250	1,923,249	1,518,383	1,729,756	1,703,933	1,532,051
Depreciation	462,215	400,993	415,354	400,351	390,346	379,607	201,773
Taxes	590,910	667,525	508,200	609,524	507,150	549,229	469,418
Total Operating Expenses	3,022,881	2,806,768	2,946,803	2,527,758	2,627,252	2,632,769	2,203,942
Electric Operating Income	\$331,445	\$968,557	\$701,994	\$877,667	\$969,889	\$1,029,804	\$525,463

ELECTRIC REVENUE

Residential	\$1,292,228	\$1,105,553	\$1,085,842	\$1,074,192	\$1,004,525	\$1,083,235	\$853,767
House Heating	277,760	273,378	285,265	276,528	273,322	255,429	164,372
Small Commercial and Industrial	743,561	730,220	710,028	679,056	672,319	640,012	437,022
Large Commercial and Industrial	1,098,307	1,125,550	1,149,193	1,167,578	1,224,320	1,278,352	1,103,316
Railroads and Railways	46,973	34,404	41,919	40,468	51,451	56,522	51,252
Public Authorities and Highway	22,315	45,234	34,274	34,339	36,541	36,975	37,668
Other Electric Sales and Interdepartmental	5,900	5,728	6,099	6,341	6,946	6,174	4,710
Other Electric Revenue	54,459	51,612	53,710	79,542	73,094	70,637	41,753
Unbilled	(25,350)	42,520	(11,100)	(520)	(6,940)	5,160	-
Service Territory	3,321,209	3,424,384	3,255,220	3,353,244	3,365,528	3,432,616	2,999,365
Interchange Sales	25,991	17,488	23,017	14,259	32,091	42,749	40,040
Sales to Other Utilities	497,326	323,454	246,450	232,912	199,462	187,208	-
Total Electric Revenue	\$2,354,326	\$2,775,325	\$2,624,797	\$2,605,425	\$2,597,141	\$2,662,573	\$2,729,405

ELECTRIC SALES

(Millions of kWh)

Residential	7,906	7,992	7,974	7,328	7,370	7,823	7,067
House Heating	2,765	2,644	2,855	2,721	2,555	2,450	1,833
Small Commercial and Industrial	6,481	6,200	6,150	5,769	5,396	5,272	4,022
Large Commercial and Industrial	15,223	15,763	15,968	15,956	15,829	16,156	15,068
Railroads and Railways	839	594	522	500	674	754	730
Public Authorities and Highway	192	156	154	189	208	201	156
Other Electric Sales and Interdepartmental	71	70	75	82	80	73	67
Unbilled	(227)	535	(205)	31	(153)	72	-
Service Territory	32,945	33,994	33,563	33,136	31,993	32,801	28,983
Interchange Sales	925	496	768	457	1,231	1,612	940
Sales to Other Utilities	20,242	14,041	10,039	8,670	6,659	5,445	-
Total Electric Sales	54,122	48,531	44,370	42,253	39,923	39,358	29,923

Residential - Average Use per Customer (kWh)	8,074	8,120	8,041	7,970	7,443	7,801	7,097
--	-------	-------	-------	-------	-------	-------	-------

AVERAGE REVENUE PER KWH

(Cents)

Residential	13.32¢	13.82¢	13.92¢	13.62¢	14.04¢	13.95¢	12.15¢
House Heating	10.05	10.34	9.39	10.17	10.53	10.43	8.99
Small Commercial and Industrial	11.53	11.78	11.55	11.77	12.46	12.14	10.87
Large Commercial and Industrial	7.22	7.20	7.20	7.22	7.73	7.91	7.22
Other	9.50	9.93	10.40	10.59	9.87	9.70	9.43
Weighted Average - Service Territory	9.95	9.92	9.84	9.39	10.29	10.25	9.17
Interchange Sales	2.73	3.53	3.00	3.12	2.61	2.65	4.25
Sales to Other Utilities	2.46	2.37	2.45	2.69	2.98	3.44	-
Weighted Average - All Classes	7.02¢	7.57¢	8.05¢	8.34¢	8.80¢	9.01¢	9.02¢

Annual operating results can be significantly affected by weather. Since the Company's peak demand is in the summer months, temperature variations in summer months are generally more significant than during winter months.

ELECTRIC CUSTOMERS

	1996	1995	1994	1993	1992	1991
Residential	1,169,954	1,169,954	1,186,391	1,180,400	1,174,340	1,170,221
House Heating	154,734	153,513	163,319	161,473	159,026	154,511
Small Commercial and Industrial	142,421	141,653	143,505	142,363	141,253	140,900
Large Commercial and Industrial	3,299	3,294	3,503	3,742	3,972	4,116
All Other	1,051	959	944	888	957	844
Total Electric Customers	1,471,229	1,467,385	1,498,262	1,489,366	1,490,009	1,470,591

ELECTRIC OPERATING INFORMATION

Output	(Millions of kWh)					
Nuclear	24,372	25,499	23,195	27,025	24,423	25,706
Coal	4,542	3,165	3,558	2,325	2,932	1,544
Coal - Minemouth	5,010	4,370	4,461	4,748	4,976	4,931
Oil Including Internal Combustion	1,203	1,100	2,404	2,397	416	980
Hydro	2,404	1,425	1,970	1,599	1,803	1,383
Pumped Storage Output	1,540	1,741	1,596	1,473	1,597	1,553
Pumped Storage Input	(2,200)	(2,507)	(2,355)	(2,192)	(2,217)	(2,255)
Interchange Purchases	18,361	13,181	5,305	5,548	7,353	7,924
Gas	179	1,823	882	637	103	-
Other	679	762	853	959	816	679
Total Output	56,561	51,070	47,014	44,365	42,397	42,479

Net Capacity	(Thousands of kW)					
Nuclear	4,090	4,040	3,938	3,938	3,938	3,938
Coal	725	725	725	690	725	683
Coal - Minemouth	709	709	709	709	709	709
Oil	1,442	1,377	1,377	1,377	1,377	1,377
Internal Combustion	842	835	815	813	797	769
Hydro	512	512	512	470	410	410
Pumped Storage	880	880	880	880	880	880
Total Net Capacity - December 31	9,201	9,078	8,956	8,377	8,326	8,766

Net Peak Load (Thousands of kW)						
Summer Peak	6,509	7,244	7,227	7,100	6,617	7,096
Annual Load Factor	62.1%	55.7%	57.2%	57.5%	59.3%	57.5%
Net Capacity (Thousands of kW) at Time of Peak (Summer Rating)	9,201	9,078	8,956	8,377	8,325	8,766
Reserve Capacity - Percent at Time of Peak	41.4%	25.3%	23.9%	25.0%	33.5%	23.5%

ELECTRIC FUEL DATA

Fuel and Interchange Expense per kWh Sold (Cents)						
Incurred	1.49¢	1.35¢	1.20¢	1.21¢	1.22¢	1.43¢
Deferred	(0.06)	(0.19)	(0.07)	(0.07)	0.14	0.10
Net	1.42¢	1.16¢	1.13¢	1.14¢	1.37¢	1.93¢

Cost of Fuel per Million Btu (Dollars)						
Nuclear	\$0.49	\$0.50	\$0.52	\$0.56	\$0.56	\$0.64
Coal	1.56	1.54	1.61	1.76	1.78	2.00
Coal - Minemouth	1.40	1.34	1.42	1.33	1.37	1.51
Oil	3.46	2.50	2.39	2.43	2.75	3.11
Internal Combustion	4.45	3.65	4.27	3.59	4.76	5.12
Gas	6.36	2.13	2.15	2.73	2.97	-

Output by Type of Fuel - %						
Nuclear	43.0%	49.9%	60.0%	60.2%	57.6%	60.5%
Coal (Including Minemouth)	16.9%	15.7%	17.1%	16.5%	17.9%	15.2%
Oil (Including Internal Combustion)	2.3%	2.2%	5.1%	5.3%	1.0%	2.3%
Interchange Purchases	32.3%	25.3%	11.3%	12.4%	18.5%	18.7%
Other	4.5%	6.4%	6.5%	5.5%	5.1%	3.2%
Total	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%

Heat Rate (Btu per Net kWh Generated)	10,582	10,705	11,617	10,575	10,557	10,849
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Operating Revenue		
Electric		\$3,854,836
Gas		428,814
Total Operating Revenue		<u>\$4,283,650</u>
Operating Expenses		
Total Operation and Maintenance		2,246,502
Provision for Depreciation and Amortization		489,001
Provision for Taxes		
Federal Income Taxes		125,702
State and Local Income Taxes		63,447
Investment Tax Credit Adjustments - Net		(15,979)
Deferred Income Taxes		168,935
Taxes Other Than Income		299,546
Total Provision for Taxes		<u>642,651</u>
(Gain) Loss on Disp of Util Assets		(131)
Total Operating Expenses		<u>\$3,378,123</u>
Operating Income		\$905,527
Other Income		
Allowance for Other Funds Used During Construction		10,222
Other Income and Deductions		(2,107)
Income Taxes		3,004
Total Other Income		<u>\$ 11,119</u>
Income Before Interest Charges		\$916,646
Interest Charges		
Interest on Long-Term Debt		328,557
Other Interest		53,886
Pref Sec Div Obl of Subsidiary		(9,725)
Allowance for Borrowed Funds - Credit		25,723
Net Interest Charges		<u>\$399,441</u>
Net Income		\$517,205
Dividends on Preferred Stocks		18,036
Earnings Available for Common Stock		<u>\$499,169</u>
Common Stock Outstanding		
End of Period (1000)		222,542
Average (1000)		222,490
Earnings per average share (dollars)		\$2.244

*purch gas 200
 Fuel & Interch 772
 O+M Expense 127
 2246*

*See Attached normalizing adjustments for
 1) STAC
 2) BCF
 3) Weather
 4) Salem*

OPERATING REVENUE

	Sales of Electricity:	
440	Residential _____	\$1,366,398
442	Commercial & Industrial _____	1,824,678
444	Public Street and Highway Lighting _____	32,815
445	Sales to Railroads and Railways _____	46,979
447	Sales for Resale _____	522,952
448	Interdepartmental Sales _____	5,865
	Total Sales of Electricity _____	<u>\$3,799,687</u>
	Other Operating Revenues:	
450	Forfeited Discounts _____	\$10,536
451	Miscellaneous Service Revenues _____	2,574
454	Rent from Electric Property _____	16,988
456	Other Electric Revenues _____	23,531
	Total Other Operating Revenues _____	<u>\$53,629</u>
	Total Electric Operating Revenues _____	\$3,853,316

OPERATING EXPENSES

401	Operation and Maintenance Expense:	
	Power Production _____	\$1,338,258
	Transmission _____	39,534
	Distribution _____	132,635
	Customer Accounts _____	137,488
	Customer Service & Information _____	24,844
	Sales _____	12,259
	Administrative and General Expense _____	301,098
	Total Operation and Maintenance Expense _____	<u>\$1,986,126</u>
403	Depreciation Expense _____	\$416,791
404	Amortization of Limited-Term Electric Plant _____	11,992
405	Amortization of Other Electric Plant _____	29,945
407	Amortization of Prop Losses, Unrec Plant _____	1,875
	Total Depreciation and Amortization _____	<u>\$460,603</u>
	Taxes	
408.1	Taxes Other Than Income Taxes _____	\$270,055
409.1	Income Taxes _____	166,896
410.1	Provision for Deferred Income Taxes _____	168,423
411.1	Inc. Taxes Deferred - Other _____	(9,439)
411.4	Investment Tax Credit Adjustments _____	(15,423)
	Total Taxes _____	<u>\$580,512</u>
411.6&7	Gain or Loss from Disposition of Util Plant _____	(2)
411.8	Gains from Disposition of Allowances _____	(74)
	Total Operating Expenses _____	<u>\$3,027,165</u>
	Operating Income _____	\$826,151

HYDRAULIC POWER GENERATION

OPERATION

535	Operation Supervision and Engineering	\$1,222
536	Water and Power	1,331
537	Hydraulic Expenses	1,543
538	Electric Expenses	-
539	Miscellaneous Hydraulic Power Gen Exp	79
540	Rents	(643)
	Total Operation	<u>\$3,532</u>

MAINTENANCE

541	Maintenance Supervision and Engineering	\$324
542	Maintenance of Structures	41
543	Maint Reservoirs, Dams & Waterways	193
544	Maintenance of Electric Plant	1,878
545	Maintenance of Misc Hydraulic Plant	538
	Total Maintenance	<u>\$2,974</u>

Total Power Production Exp - Hydraulic \$6,506

OTHER POWER GENERATION

OPERATION

546	Operation Supervision and Engineering	\$790
547	Fuel	14,392
548	Generation Expenses	487
549	Miscellaneous Other Power Gen Exp	811
550	Rents	-
	Total Operation	<u>\$16,480</u>

MAINTENANCE

551	Maintenance Supervision & Engineering	\$879
552	Maintenance of Structures	131
553	Maint of Generating and Electric Plant	3,466
554	Maint of Miscellaneous Other Power	129
	Total Maintenance	<u>\$4,605</u>

Total Power Production Exp - Other Pwr \$21,085

OTHER POWER SUPPLY EXPENSES

555	Purchased Power	\$476,318
556	System Control and Load Dispatching	6,828
557	Other Expenses	(32,202)
	Total Other Power Supply Expenses	<u>\$450,944</u>

Total Power Production Expenses \$1,338,258

PECO Energy Company - Electric Operations
ADJUSTMENT TO REFLECT THE FULL YEAR EFFECT
OF THE STAC ON REVENUES AND EXPENSES
Twelve Months Ended December 31, 1996
(Thousand \$)

The purpose of this adjustment is to reflect the full year effect of the elimination of the STAC credit value of 0.23%. The credit ended on September 23, 1996. Additionally, this adjustment reflects an increase in PURTA tax due to a reassessment. Further discussion is contained in the Direct Testimony of Thomas P. Hill, Jr.

Increase in Revenues	55,842
Increase in PURTA Expense	723
Increase in Taxable Income	5,119
Increase in Taxes at 41.494%	2,124
Increase in Income for Return	2,995

PECO Energy Company - Electric Operations
 ADJUSTMENT TO REFLECT THE FULL YEAR EFFECT OF YEAR END FUEL
 ADJUSTMENT REVENUES AND EXPENSES
 Twelve Months Ended December 31, 1996
 (Thousand \$)

The purpose of this adjustment is to reflect the full year effect on revenues and expenses of the year end Energy Cost Adjustment Number 7 value of (0.4424) cents/kWh that was rolled into base rates. The Direct Testimony of Thomas P. Hill, Jr. provides further discussion of this item.

Increase in Revenues	\$6,507
Increase in Expenses	\$6,221
Increase in Gross Receipts Tax .044 x \$6,507	\$286
Increase in revenues less expenses and taxes	-
Change in Income Taxes at 41.494%	-
Change in income for return	-

Scheduled Long Term Debt Maturities
(\$ Millions)

	<u>Issue</u>	<u>Amount</u>
1998	5.375% series due 1998	225.0
	7.41% series due 1998	12.4
	10.25% series due 2007	4.1
	Total	241.5
1999	7.5% series due 1999	250.0
	9.25% series due 1999	75.0
	9.08% series due 1999	30.0
	10.25% series due 2007	4.1
Total	359.1	
2000	10.25% series due 2007	4.1
2001	5.625% series due 2001	250.0
	7.375% series due 2001	80.0
	10.25% series due 2007	4.1
	Total	334.1
2002	8.0% series due 2002	200.0
	7.125% series due 2002	200.0
	7.5% series due 2002	100.0
	10.25% series due 2007	4.1
Total	504.1	
2003	6.625% series due 2003	250.0
	6.5% series due 2003	200.0
	10.25% series due 2007	4.1
Total	454.1	
2004	10.25% series due 2007	4.1
2005	6.375% series due 2005	75.0
	9.1% MTN series due 2005	10.0
	9.09% MTN series due 2005	10.0
	10.25% series due 2007	4.1
Total	99.1	
2006	10.25% series due 2007	4.1
2007	10.25% series due 2007	4.1
2008	None	-

PECO Energy Company - Electric Operations
 ADJUSTMENT TO REVENUES AND EXPENSES
 TO REFLECT WEATHER NORMALIZED SALES
 Twelve Months Ended December 31, 1996
 (Thousand \$)

The purpose of this adjustment is to reflect the effect of weather normalization on revenues and expenses. Refer to the Direct Testimony of Thomas P. Hill, Jr. for further discussion of this adjustment.

<u>Increase in Revenues</u>		
Residential	194,620 MWh	\$30,080
Residential Heating	(28,260) MWh	2,930
Small Commercial and Industrial	54,410 MWh	4,070
Large Commercial and Industrial	120,230 MWh	<u>4,940</u>
<u>Less: Increase in Expenses</u>		\$42,020
Fuel Expenses		
Residential		4,800
Residential Heating		(710)
Small Commercial and Industrial		1,370
Large Commercial and Industrial		<u>2,970</u>
		8,430
Gross Receipts Tax		1,849
Increase in Revenue Net of Fuel and Gross Receipts Tax		31,741
Increase in Income Taxes at 41.494%		13,171
Increase in Income for Return		18,570

PECO Energy Company - Electric Operations
 ADJUSTMENT TO ELIMINATE SALEM STATION
 SHUTDOWN O&M EXPENSES FROM THE TEST YEAR
 Twelve Months Ended December 31, 1996
 (Thousand \$)

The purpose of this adjustment is to eliminate all fuel and nonfuel expense attributable to the shutdown of Salem Station during the test year. Refer to the Direct Testimony of Thomas P. Hill, Jr. for further discussion of this adjustment.

Replacement Power	\$92,100	
Outage Expenses	<u>57,437</u>	
Reduction in Expenses		\$149,537
Increase in Taxes @ 41.494%		\$62,049
Increase in Income for Return		\$87,488

Scheduled Preferred Stock Maturities
(\$ Millions)

	<u>Issue</u>	<u>Amount</u>
1998	None	-
1999	\$6.12 series (with mandatory redemption)	18.5
2000	\$6.12 series (with mandatory redemption)	18.5
2001	\$6.12 series (with mandatory redemption)	18.5
2002	\$6.12 series (with mandatory redemption)	18.5
2003	\$6.12 series (with mandatory redemption)	18.5
2004	None	-
2005	None	-
2006	None	-
2007	None	-
2008	None	-

Subject to Completion
 Dated November 10, 1997

Preliminary Prospectus Supplement
 (To Prospectus dated _____, 1997)

\$
California Infrastructure and Economic Development Bank
Special Purpose Trust SCE-1

Rate Reduction Certificates, Series 199 -

\$	Class	% Certificates
[\$	Class	Floating Rate Certificates]

SCE Funding LLC

Issuer of the Notes

Southern California Edison Company

Seller and Servicer

The Offered Certificates do not represent an interest in or obligation of the State of California, the Infrastructure Bank, any other governmental agency or instrumentality or the Seller or any of its affiliates. None of the Offered Certificates, the Underlying Notes or the Transition Property will be guaranteed or insured by the State of California, the Infrastructure Bank, the Trust or any other governmental agency or instrumentality or by the Seller or its affiliates.

(Continued on following page)

THESE SECURITIES HAVE NOT BEEN APPROVED OR DISAPPROVED BY THE SECURITIES AND EXCHANGE COMMISSION OR ANY STATE SECURITIES COMMISSION NOR HAS THE SECURITIES AND EXCHANGE COMMISSION OR ANY STATE SECURITIES COMMISSION PASSED UPON THE ACCURACY OR ADEQUACY OF THIS PROSPECTUS. ANY REPRESENTATION TO THE CONTRARY IS A CRIMINAL OFFENSE.

THERE CURRENTLY IS NO SECONDARY MARKET FOR THE OFFERED CERTIFICATES, AND THERE IS NO ASSURANCE THAT ONE WILL DEVELOP.

PROSPECTIVE INVESTORS SHOULD CONSIDER, AMONG OTHER THINGS, THE INFORMATION SET FORTH UNDER THE CAPTION "RISK FACTORS," WHICH BEGINS ON PAGE 26 IN THE PROSPECTUS.

		Price to Public(1)	Underwriting Discount	Proceeds to Trust(1)(2)
Per Class	Certificate	%	%	%
Per Class	Certificate	%	%	%
Per Class	Certificate	%	%	%
Per Class	Certificate	%	%	%
Per Class	Certificate	%	%	%
Total		\$	\$	\$

(1) Plus accrued interest, if any, at the applicable Certificate Interest Rate from _____, 199 .
 (2) Before deduction of expenses estimated to be \$ _____

The Offered Certificates are offered by the Underwriters when, as and if issued by the Trust and accepted by the Underwriters and subject to the Underwriters' right to reject orders in whole or in part. It is expected that the Offered Certificates will be delivered on or about _____, 199 , in book-entry form through the facilities of The Depository Trust Company[, Cedel Bank, société anonyme, and the Euroclear System].

Salomon Brothers Inc

Lehman Brothers

Chase Securities Inc.

Goldman, Sachs & Co.

PaineWebber Incorporated

Artemis Capital Group, Inc. Blaylock & Partners, L.P. Utendahl Capital Partners, L.P.

The date of this Prospectus Supplement is _____, 199

Information contained herein is subject to completion or amendment. A registration statement relating to these securities has been filed with the Securities and Exchange Commission. These securities may not be sold nor may offers to buy be accepted prior to the time the registration statement becomes effective. This Prospectus Supplement shall not constitute an offer to sell or the solicitation of an offer to buy nor shall there be any sale of the securities in any jurisdiction in which such offer, solicitation or sale would be unlawful prior to registration or qualification under the securities laws of such jurisdiction.

RISK FACTORS

Investors should consider, among other things, the following factors in connection with the purchase of Certificates:

Unusual Nature of the Transition Property

Reliance on FTA Adjustments

The Servicer will be obligated to submit True-Up Mechanism Advice Letters to the CPUC at least annually and, if so specified in the related Prospectus Supplement, as often as quarterly, seeking adjustments to the FTA Charges to reflect the actual rate of FTA Collections and changes in projections regarding such rate. Such adjustments will also reflect amounts available in the General Subaccount and Reserve Subaccount and amounts required to fund the Overcollateralization Subaccount and replenish the Capital Subaccount to required levels. The actual rate of FTA Collections will vary from projections upon which the FTA Charges were based, primarily as a result of variations from projected electricity usage by Customers and expected delinquencies and write-offs. PU Code Section 841(c) requires the CPUC to approve adjustments requested by True-Up Mechanism Advice Letters necessary to assure timely recovery of Transition Costs, including interest on and principal of the Certificates in accordance with the related Expected Amortization Schedule, the funding of the Overcollateralization Subaccount and payment of related fees and expenses. Despite the Statute and the Financing Order, there can be no assurance that the CPUC will approve such requests in a timely manner. Any delay in adjustments to the FTA Charges, and any litigation that might ensue as a consequence, might adversely affect the price and liquidity of the Certificates and the dates of maturity thereof, and, accordingly, the weighted average lives thereof.

Possible State Amendment or Repeal of the Statute and Related Litigation

Under the Statute, the State of California pledged and agreed with the owners of Transition Property and the holders of the Certificates, and the Infrastructure Bank as agent for the State of California will pledge and agree in the Trust Agreement for the benefit of Certificateholders, that the State will neither limit nor alter the fixed transition amounts, transition property, financing orders and all rights thereunder until all obligations under the Certificates are fully met and discharged; provided that nothing contained in the Statute or the Trust Agreement precludes such limitation or alteration by the State if and when adequate provision shall be made by law for the protection of the Certificateholders. It is unclear what "adequate provision" would be afforded to Certificateholders by the State if such limitation or alteration were attempted. Accordingly, no assurance can be given that any such provision would not adversely affect the price of the Certificates, or the timing of receipt of payments with respect to the Certificates.

Under California law, the electorate has the right, through its initiative powers, to propose statutes as well as amendments to the California Constitution. Generally, any matter that is a proper subject of legislation can become the subject of an initiative. Among other procedural requirements, in order for an initiative measure to qualify for an election, the initiative measure must be submitted to the State Attorney General and a petition signed by electors constituting five percent, in the case of a statutory initiative, and eight percent, in the case of a constitutional initiative, of the votes cast at the immediately preceding gubernatorial election must be submitted to the Secretary of State. To become effective, the initiative must then be approved by a majority vote of the electors voting at the next general election.

Consumer advocacy groups have publicly announced their opposition to certain elements of the restructuring plan embodied in the Statute, including the ability of the Utilities to recover fully their stranded costs and the issuance of the Certificates. These opponents have indicated their intent to commence litigation to prevent the sale of the Certificates and have challenged the validity of the Financing Order, as described below under "—Legal Challenges." In addition, opponents who include Ralph Nader and the head of a prior successful initiative campaign relating to automobile insurance have announced their intention to draft a ballot initiative intended to eliminate the recoveries of stranded costs, including the cost of nuclear plants, and intended to

prohibit the collection of FTA Charges. The first step in commencing the initiative qualification process would be a submission of an initiative measure to the State Attorney General. No assurances are given as to whether any such litigation will commence, whether any such voter initiative measure will be introduced or adopted, the terms of any such voter initiative measure or the effect of any such litigation or voter initiative measure on the Certificate.

In the opinion of Brown & Wood LLP, counsel to the Trust ("Special Counsel"), under applicable United States and State of California Constitutional principles relating to the impairment of contracts, the State of California could not repeal or amend the Statute (by way of either legislative process or California voter initiative) or take, or refuse to take, any action required by the State of California under its pledge and agreement with the Certificateholders (described above) if such repeal or amendment, or such action or inaction would substantially impair the rights of the Certificateholders, absent a demonstration by the State of California of a "great public calamity" that justifies a contractual impairment. There have been numerous cases in which legislative or popular concerns with the burden of taxation or governmental charges have led to adoption of legislation reducing or eliminating taxes or charges which supported bonds or other contractual obligations entered into by public instrumentalities. However, such concerns have not been considered by the courts to provide sufficient justification for a substantial impairment of the security for such bonds or obligations provided by the taxes or governmental charges involved. Based upon such analogous case law (which, however, does not address these particular circumstances directly), it would appear unlikely that the State could reduce, modify or alter the Transition Property, or take, or refuse to take, any action with respect to the Transition Property in a manner which would substantially impair the rights of the Note Issuer, as owner of the Transition Property, or of Certificateholders. Nonetheless, no assurance can be given that a repeal of or amendment to the Statute will not be sought or adopted or that any action, or refusal to act, by the State may not occur, any of which might constitute a violation of the State's pledge and undertaking with the Certificateholders. In any such event, costly and time consuming litigation might ensue. Any such litigation might adversely affect the price and liquidity of the Certificates and the dates of maturity thereof, and, accordingly, the weighted average lives thereof. Moreover, given the lack of judicial precedent directly on point, and the novelty of the security for the Certificates, the outcome of any such litigation cannot be predicted with certainty and, accordingly, Certificateholders could incur a loss on their investment.

Furthermore, Section 3 of Article XIII C of the California Constitution ("Proposition 218") provides that the initiative process shall not be prohibited or otherwise limited in matters of reducing or repealing any "local" tax, assessment, fee or charge. There is no controlling precedent interpreting Proposition 218, given its recent adoption. However, in the opinion of Special Counsel, the FTA Charges are not a "local" tax, assessment fee or charge to which Proposition 218 applies, and the initiative power described in Proposition 218 is therefore inapplicable to the FTA Charges, the Transition Property, the Notes and the Certificates.

Possible Federal Preemption of the Statute

At least one bill was introduced in the 105th Congress, First Session, prohibiting the recovery of stranded costs such as the Transition Costs, which could negate the existence of the Transition Property that is the source of payments on the Notes and the Certificates. The bill is H.R. 1230 (The Consumers Electric Power Act of 1997) ("H.R. 1230"), which was introduced on April 8, 1997, and has been referred to the House Commerce Committee, where no further action has been taken. However, the entire 52-member California delegation to the House of Representatives is on record opposing any federal bill that does not grandfather the provisions of the Statute. No prediction can be made as to whether H.R. 1230, or any future proposed bill that would prohibit the recovery of stranded costs, will become law or, if it becomes law, what its final form or effect will be. Federal preemption of the Statute could prevent Certificateholders from receiving the principal and interest payable on the Certificates and Certificateholders could suffer a loss on their investment. See "Energy Deregulation and the New California Market Structure" herein.

Legal Challenges

The existence of the Transition Property and its adequacy as a source of distributions on the Certificates are dependent on relevant provisions of the PU Code, the Financing Order and applicable Advice Letters. In addition, resolutions adopted by the Infrastructure Bank relating to the issuance of the Certificates are subject to legal challenge within 60 days of their adoption. If the relevant provisions of the PU Code, the Financing Order or any such Advice Letters were determined to be unlawful, invalid or unenforceable in whole or in part, or if the resolutions of the Infrastructure Bank were determined to be invalid, any such determination could adversely affect the validity of the Certificates or the ability of the Note Issuer to make timely payments on the Notes, and in either case, the Certificateholders could suffer a loss. At the time of issuance of the Certificates, the General Counsel of the Infrastructure Bank will deliver an opinion to the effect that the issuance resolutions were validly adopted and are in full force and effect at such time.

On October 6, 1997, The Utility Reform Network ("TURN"), a California consumer advocacy group, filed an application for rehearing with the CPUC seeking rehearing of the Financing Order, alleging that the Financing Order is unlawful on various grounds. The CPUC denied the applications for rehearing on October 22, 1997. TURN has announced that it will challenge the CPUC's denial by filing a petition for writ of review of the Financing Order with the California Supreme Court. If the petition for writ of review were to be granted by the California Supreme Court under the PU Code, the court would determine only whether the CPUC acted within its authority in issuing the Financing Order. A decision by the California Supreme Court to hear such a case in and of itself could adversely affect the liquidity and value of the Certificates.

As of the date of this Prospectus, the Financing Order is in full force and effect. If the relevant provisions of the Financing Order, the PU Code or any Advice Letters are determined to be unlawful, invalid or unenforceable under existing law, such determination may result in a breach of a representation and warranty requiring the Seller, under certain circumstances, to repurchase the Transition Property as described under "Description of the Transition Property—Seller Representations and Warranties and Repurchase Obligation" herein. No assurances are given that Edison, as Seller, will be able to repurchase the Transition Property.

Uncertainties Associated with New Asset Type

There are no historical performance data for an asset type such as the Transition Property. Although energy usage records are available, such records have limited predictive value with respect to the Certificates. Furthermore, the Servicer does not have any experience administering this specific type of regulatory asset. See "Servicing" herein. In addition, foreclosure upon the Transition Property may not be a realistic or practical remedy for the Certificateholders.

Limited Rights and Remedies

Under the terms of the Sale Agreement, Edison, as the Seller, will be required to repurchase the Transition Property, at a purchase price equal to the outstanding principal amount of the Notes and all accrued and unpaid interest thereon as of the repurchase date, if, among other things, there has been a breach of the Seller's representation that the Financing Order and each Issuance Advice Letter pursuant to which any applicable Transition Property has been created are valid, binding and irrevocable as of the date of any sale of Transition Property but only if such breach continues beyond a 90-day grace period and has a material adverse effect on the Certificateholders. A determination by a court that, based on laws in effect on the date any Transition Property is sold, the Transition Property, the Financing Order or any Issuance Advice Letter violated any such laws, or is otherwise invalid or unenforceable, would be considered to be a breach of the Seller's representation, thereby obligating the Seller to repurchase the Transition Property under the Sale Agreement. The Seller will not be in breach of any representations and warranties as a result of a change in law by legislative enactment, voter initiative or constitutional amendment, including a breach of the State Pledge, or as a result of a breach of the State Pledge otherwise effected that constitutes a temporary impairment of the Certificateholders' rights which under current law would be permitted as necessary to advance an important public interest, as described below.

No assurances are given that the Seller will be able to repurchase the Transition Property. In the event of any such repurchase, the Note Issuer would be obligated to redeem the Notes and accordingly cause the Trust to redeem the Certificates. See "Description of the Transition Property—Seller Representations and Warranties and Repurchase Obligation" herein.

In contrast, the Seller will not be required to repurchase the Transition Property if the FTA Charges become uncollectible as a result of a change in law by any legislative enactment, voter initiative or constitutional amendment occurring after the date the Transition Property is sold. In addition, no breach of the Seller's representations will be deemed to have occurred if the State breaches the State Pledge by otherwise effecting a temporary impairment of the Certificateholders' rights which under current law would be permitted as necessary to advance an important public interest. Such a public interest may arise in connection with a great public calamity, which might include, for example, economic upheaval or natural disasters. A repeal of the Statute, an amendment thereto voiding the Transition Property or the adoption of a federal statute prohibiting the recovery of all stranded costs are examples of changes in law. If any such event were to occur, the Servicer, on behalf of the Certificateholders, would be required to bring legal action seeking to overturn any such change in law. The Servicer would be entitled to reimbursement of its expenses in connection with such legal or administrative action as an operating expense of the Trust under the Note Indenture. Any such litigation might adversely affect the price and liquidity of the Certificates and the dates of maturity thereof, and, accordingly, the weighted average lives thereof. Moreover, given the lack of judicial precedent directly on point, and the novelty of the security for the Certificates, the outcome of any such litigation cannot be predicted with certainty and, accordingly, Certificateholders may suffer a loss of their investment in the Certificates.

Potential Servicing Issues

Reliance on Servicer

The Trust relies on the Servicer for the determination of any adjustments to the FTA Charges and for the Customer billing and collection that is necessary to recover the FTA Payments and, therefore, necessary to make distributions on the Certificates. If, as a result of its insolvency or liquidation or otherwise, Edison were to cease servicing the Transition Property, determining any adjustments to the FTA Charges or collecting FTA Payments, it may be difficult to find a substitute servicer. In such an event, the timing of recovery of payment on the Transition Property could be delayed. Any successor servicer under current law may not be able to invoke a remedy of shutting off service to a consumer for nonpayment of the FTA Charge. A successor servicer may otherwise experience difficulties in collecting FTA Payments and determining appropriate adjustments to FTA Charges. A transfer of servicing will require regulatory cooperation. See "Servicing" herein.

Inaccurate Usage and Credit Projections

The ability of the Servicer to forecast accurately the electricity usage of Customers and the delinquency and write-off experience relating to FTA Payments will affect significantly whether Certificateholders will receive timely distributions on the Certificates. Actual energy usage may differ from projections as a result of weather during the relevant period that is warmer or cooler than expected. In addition, actual energy usage, delinquencies and write-offs may differ from projections as a result of general economic conditions, trends in demographics that are not precisely as predicted, unexpected catastrophes, and other causes. During the past five years, the Servicer's forecasts for energy consumption have averaged a 0.3 percent overestimate of usage for Residential Customers and a 2.7 percent underestimate of usage for Small Commercial Customers. See "The Seller and Servicer—Forecast Variance" herein. The accuracy of the Servicer's historical forecasts is not necessarily indicative of the accuracy of the Servicer's future forecasts, and there can be no assurances that actual usage, delinquencies and write-offs will not be significantly different from future forecasts thereof. The adjustment mechanism for the FTA Charges described under "Description of the Transition Property—Adjustments to the FTA Charges," as well as the Overcollateralization Amount and the amounts deposited in the Capital Subaccount, are intended to mitigate these risks relating to the timing of collections and payments, although the frequency of the adjustments to the FTA Charges is limited, and, accordingly, delays in distributions to Certificateholders might result. See "The Seller and the Servicer—Credit Policy; Billing; Collections; Restoration of Service" herein.

Delays Caused by Changes in Payment Terms

The Servicer is permitted to alter the terms of billing and collection arrangements and modify amounts due from Customers. Although the Servicer does not have the right to change the amount of a Customer's individual FTA Charge, it does have the right to take actions that in its judgment will maximize actual collections from Customers with respect to any utility bill. In addition, the Servicer has the right to write off outstanding bills that it deems uncollectible in accordance with its customary practices. Such actions might include, for example, agreeing to an extended payment schedule or agreeing to write off a portion of an outstanding bill in order to recover a portion thereof. While Edison has no current intention of taking actions that would change the billing and collection arrangements in a manner which would affect adversely the collection of FTA Payments, there can be no assurance that changes in Edison's customary and usual practices for comparable assets it services for itself might not result in a determination to do so or that a successor servicer may not make such a determination. *It is possible that any such changes could delay collections from Customers or result in lower collections, and accordingly could adversely affect the distribution of interest on the Certificates on a timely basis or the distribution of the principal of the Certificates pursuant to the Expected Amortization Schedules or in full by the applicable Scheduled Final Distribution or Termination Dates. See "Certain Distribution, Weighted Average Life and Yield Considerations" herein.*

Limited Credit Policy and Procedures

The ability of the Servicer to collect amounts billed to Customers under the FTA Charges, as adjusted from time to time, will depend in part on the creditworthiness of the Customers. Edison generally is obligated to provide service to new Customers under California law, and generally no outside credit investigations are performed on new Customers. Edison's information regarding the credit status of new Customers is limited to information regarding prior service, if any, by Edison to such Customers. Edison relies on the information provided by Customers and its customer information system audits to indicate whether a new Customer has had previous service from Edison. If Edison evaluates the creditworthiness of a significant number of its Customers incorrectly, resulting in significant increases in delinquencies and write-offs, delays in distributions to Certificateholders may occur. It is expected that by the middle of 1998, the creditworthiness of new Customers will be verified using an on-line credit bureau database. If a Customer falls below a specific credit score, a security deposit will be required. See "The Seller and Servicer—Credit Policy; Billing; Collections; Restoration of Service" herein.

Reliance on Aggregators and Other Suppliers

As part of the deregulation of the California electric industry described elsewhere herein, there will be an unbundling of generation, transmission, distribution and billing services. A decision of the CPUC allows alternative energy services providers ("ESPs") to provide a consolidated bill to their retail customers covering amounts owed to the ESP for electricity, amounts owed to the utilities for distribution and other charges, including the applicable FTA Charges.

The CPUC has determined that if an ESP provides consolidated billing, the ESP must first establish its creditworthiness by either (1) demonstrating that it has a credit rating of "Baa2" or higher from Moody's or "BBB" or higher from S&P, Fitch Investors Service, L.P. or Duff & Phelps Credit Rating Co., (2) submitting a credit application to the Servicer for evaluation, with final credit approval granted by the Servicer, or (3) submitting to the Servicer a deposit equal to twice the estimated maximum monthly amount owed to the Servicer. Any ESP that provides consolidated billing, including monthly amounts with respect to the FTA Charges, is required to pay the utility periodic amounts billed by the utility to the ESP, including the FTA Charges, regardless of the ESP's ability to collect such amounts from its Customers. In such event, the collecting ESP will, in effect, replace the Customer as the obligor with respect to such FTA Charges, and the Servicer, on behalf of the Note Issuer, will have no right to collect such FTA Charges from the Customer. There can be no assurance that each ESP will utilize the same customer credit standards as the Servicer, or that the Servicer will be able to mitigate credit risks relating to ESPs in the same manner in which it mitigates such risks relating to its

Customers. See "Servicing—Aggregators and Other Suppliers" herein. The Servicer, on behalf of the Note Issuer, will pursue any ESP that fails to remit applicable FTA Charges in a manner similar to that by which the Servicer will pursue any failure by a Customer to remit FTA Charges. The Servicer will not have the right to pursue Customers of an ESP that defaults in the payment of FTA Charges. However, the Servicer will have the right to revert to separate billing upon certain payment defaults by an ESP. An ESP that has defaulted will nevertheless have the right to reinstate consolidated billing six months after its default upon the satisfaction of certain conditions. Frequent changes in Customer billing and payment arrangements may result in Customer confusion and the misdirection or delay of payments, which could have the effect of causing delays in distributions to Certificateholders. Neither the Seller nor the Servicer will pay any shortfalls resulting from the failure of any ESPs to forward FTA Payments to Edison, as Servicer. The true-up adjustment mechanism for the FTA Charges, as well as the Overcollateralization Amount and the amounts deposited in the Capital Subaccount, are intended to mitigate this risk relating to the timing of collections and payments. However, delays in distributions to Certificateholders might occur as a result of delays in implementation of the adjustment mechanism.

In addition, to the extent that Customers choose to purchase their electricity from ESPs that provide consolidated billing, the Note Issuer may be relying on a small number of ESPs, rather than a large number of Customers, to remit FTA Charges. Under these circumstances, a default in the payment of FTA Charges by a single ESP that provides electricity services to a large number of Customers may adversely affect the timing of payments on the Certificates.

Commingling of FTA Payments with Servicer's Other Funds; Investment of FTA Payments for Servicer's Account

Except as described under "Servicing—Remittances to Collection Account" herein, on each Remittance Date the Servicer will remit to the Collection Account FTA Payments expected to have been received during the preceding Collection Period. Accordingly, FTA Payments received by the Servicer will not be segregated from the Servicer's general funds until they are remitted to the Collection Account. The Servicer will invest FTA Payments received but not yet remitted for its own account. A failure or inability of the Servicer to remit the full amount of the estimated FTA Payments on any Remittance Date, whether voluntary or involuntary, might result in delays in distributions to Certificateholders. The true-up adjustment mechanism as well as the Overcollateralization Amount and the amounts deposited in the Capital Subaccount, are intended to mitigate this risk relating to the timing of collections and payments. However, delays in distributions to Certificateholders may occur as a result of delays in implementation of the adjustment mechanism. Furthermore, six months after the Billing Period during which bills are rendered, the Actual FTA Payments with respect to such Billing Period are determined. If there has been a Remittance Shortfall (*i.e.*, Actual FTA Payments exceed Estimated FTA Payments), the Servicer is required to increase the amount that it otherwise would remit on the Remittance Date following the calculation of the Remittance Shortfall, with such increased amount coming from its own funds. In the event of the insolvency of the Servicer, payments of the Remittance Shortfall by the Servicer may be delayed significantly.

Uncertainties Related to the Electric Industry Generally

Untried New California Market Structure

The California electric industry will change dramatically in the near future, as a result of recent decisions by the CPUC and enactment of the Statute. See "Energy Deregulation and New California Market Structure" herein. The new California electric market structure, scheduled to begin January 1, 1998, has neither been tested nor implemented. Many elements of the new market structure present novel regulatory issues yet to be resolved as well as many practical issues of implementation such as the development of systems, software and procedures for each of (a) the independent power exchange (the "PX"), which will provide an auction process to match electricity supply and demand, (b) the independent system operator (the "ISO"), which will have operational control of the Utilities' transmission facilities and (c) all of the market participants who will transact with the PX and ISO. If the new market structure is not implemented in a timely and orderly fashion, electricity

generation, transmission and distribution may be adversely affected. FTA Payments may not be made as expected, the Servicer's business may be affected or Certificateholders may fail to receive distributions of principal and interest.

Changing Regulatory Environment

In addition to actions taken by the California Legislature and regulation by the CPUC, the electric industry is also subject to federal law and regulation by the Federal Energy Regulatory Commission (the "FERC"). At least five bills were introduced into the 105th Congress, First Session, mandating the deregulation of the electric utility industry on the state level. In general, the bills provide for open competition in the furnishing of electricity to all retail customers. As described above under "*—Unusual Nature of the Transition Property—Possible Federal Preemption of the Statute,*" at least one of the bills may prohibit the recovery of FTA Charges; however, none of the bills has passed in committee. No prediction can be made as to whether these bills, or any future proposed bills to mandate the deregulation of the electric industry, will become law or, if they become law, what their final form or effect would be. Any changes in the existing legal structure regulating the electric industry might have an impact on the manner in which electricity is distributed and payments therefor are collected, or on the Servicer and its business, and thus the likelihood that Certificateholders will receive distributions in the amounts and at the times scheduled.

Changes in General Economic Conditions and Electricity Usage

General economic conditions and technological changes that would significantly alter power consumption or reduce the residential and small commercial consumer base in the Seller's historical service area may affect payments on the Notes and, accordingly, distributions on the Certificates. Changes in business cycles, departures of Customers from the Seller's historical service area, weather, occurrence of natural disasters such as earthquakes and floods, implementation of energy conservation efforts and increased efficiency of equipment all affect energy usage. If a sufficient number of Customers reduce significantly their electricity consumption or cease consuming electricity altogether, the FTA Charges, as adjusted from time to time through True-Up Mechanism Advice Letters, as described herein, required to be paid by each remaining Customer may become burdensome. See "*—Unusual Nature of the Transition Property—Reliance on FTA Adjustments*" herein.

Reliance on Broad Base of Customers

The FTA Charges are relatively modest in amount on an individual Customer basis, when imposed on the Seller's current base of Customers. However, if one or more of the risks described under the heading "*—Uncertainties Relating to the Electric Industry Generally*" or an unforeseen catastrophe were to occur, the number of Customers on whom the FTA Charges would be levied might be reduced significantly. Such a reduction would increase the amount of the applicable FTA Charge for each Customer, which might cause more Customers to avoid paying the applicable FTA Charge after the Rate Freeze Period by leaving the Territory. If the number of Customers were to be substantially reduced, the remaining Customers might be unable or unwilling to pay the FTA Charges. Alternatively, a reduced number of Customers and corresponding higher per kilowatt-hour FTA Charges might increase the reluctance of the CPUC to allow adjustments to the FTA Charges or provide greater incentive for the California legislature to amend the Statute in a manner intended to reduce or eliminate the FTA Charges in respect of the Transition Property. Although the Note Issuer believes that the likelihood of this scenario occurring is remote, this result might cause Certificateholders to fail to receive the full amount of distributions to which they are entitled. Furthermore the Note Issuer expects that the applicable FTA Charge could be imposed on certain Customers who self-generate their electricity, based on historical usage. However, the ability of the Servicer to collect such FTA Charges may be limited because the Servicer will not have ready access to data about which consumers are self-generating and will not be able to exercise shut-off rights as an enforcement tool against a self-generator. Nevertheless, the Servicer's current forecasts of future electricity demand do not include any shift by Customers to self-generation because self-generation of electricity by Customers is not expected to be economically viable during the period in which the Certificates will be outstanding.

In addition, to the extent that Customers choose to purchase their electricity from ESPs that provide consolidated billing, the Note Issuer may be relying on a small number of ESPs, rather than a large number of individual Customers, to remit FTA Payments. Under these circumstances, a default in the payment of FTA Charges by a single ESP that provides electricity services to a large number of Customers may adversely affect the timing of payments on the Certificates. See “—Potential Servicing Issues—Reliance on Aggregators and Other Suppliers” and “Servicing—Aggregators and Other Suppliers” herein.

Bankruptcy and Creditors’ Rights Issues

Potential Bankruptcy of Seller

The Seller will represent and warrant in the Sale Agreement that the transfer of the Transition Property pursuant thereto to the Note Issuer is a valid sale and assignment of such Transition Property from the Seller to the Note Issuer. The Seller and the Note Issuer will also represent and warrant that they will each take the appropriate actions under the PU Code to perfect this sale. The Statute provides that the transactions described in the Sale Agreement shall constitute a sale of the Transition Property to the Note Issuer, and the Seller and the Note Issuer will treat the transactions as a sale under applicable law, although for financial reporting purposes the transactions will be treated as debt of the Seller. If the Seller were to become a debtor in a bankruptcy case, and a creditor or bankruptcy trustee of the Seller or the Seller itself as debtor in possession were to take the position that the sale of the Transition Property to the Note Issuer should be recharacterized as a pledge of such Transition Property to secure a borrowing of the Seller, and a court were to adopt such position, then delays or reductions in distributions on the Certificates could result. Regardless of any specific adverse determinations in an Edison bankruptcy proceeding, the fact of an Edison bankruptcy proceeding could have an adverse effect on the liquidity and value of the Certificates.

The Seller and the Note Issuer have taken steps to minimize the risk that in the event the Seller or an affiliate of the Seller were to become the debtor in a bankruptcy case, a court would order that the assets and liabilities of the Seller or such affiliate be substantively consolidated with those of the Note Issuer. The Note Issuer is a separate, special purpose limited liability company, the organizational documents of which provide that it shall not commence a voluntary bankruptcy case without the unanimous affirmative vote of all of its directors. Nonetheless, no assurance can be given that if the Seller or an affiliate of the Seller were to become a debtor in a bankruptcy case, a court would not order that the assets and liabilities of the Note Issuer be consolidated with those of the Seller or such affiliate, thus resulting in delays or reductions in distributions on the Certificates.

Should the transfer of the Transition Property to the Note Issuer be recharacterized as a borrowing by the Seller, the Statute provides that there is a perfected first priority statutory lien on the Transition Property that secures all obligations to the holders of the Certificates. In addition, in the Sale Agreement, the Seller grants to the Note Issuer a security interest in the Transition Property and covenants that the appropriate actions will be taken to perfect such security interest, although the Seller takes the position that it has no rights in the Transition Property to which a security interest could attach.

Pursuant to the Statute and the Financing Order, upon the effective date of each Issuance Advice Letter associated with the Financing Order, the Transition Property identified in such Issuance Advice Letter constitutes a current property right and it thereafter continuously exists as property for all purposes. Nonetheless, no assurances can be given that if the Seller were to become the debtor in a bankruptcy case, a creditor of, or a bankruptcy trustee for, the Seller or the Seller itself as debtor in possession would not attempt to take the position that, because the payments based on the FTA Charges are usage-based charges, Transition Property comes into existence only as Customers use electricity. If a court were to adopt this position, no assurances can be given that either the statutory lien created by the Statute or the security interest granted in the Sale Agreement would attach to FTA Collections in respect of electricity consumed after the commencement of a bankruptcy case by or against the Seller. If it were determined that the Transition Property has not been sold to the Note Issuer, and that the statutory lien created by the Statute and the security interest granted in the Sale Agreement do not attach to collections of FTA Payments in respect of electricity consumed after the commencement of a bankruptcy case

of the Seller, then the Certificate Trustee, as Noteholder and for the benefit of holders of the Certificates, would be an unsecured creditor of the Seller, and delays or reductions in distributions on the Certificates could result. Whether or not the court determined that the Transition Property had been sold to the Note Issuer, no assurances can be given that the court would not rule that any FTA Payments relating to electricity consumed after the commencement of the Seller's bankruptcy cannot be transferred to the Note Issuer or the Certificate Trustee, thus resulting in delays or reductions of distributions on the Certificates.

Because the FTA Charges arise from usage-based charges, if the Seller were to become the debtor in a bankruptcy case, a creditor of, or a bankruptcy trustee for, the Seller, or the Seller itself as debtor in possession could take the position that the Note Issuer should pay a portion of the costs of the Seller associated with the generation, transmission, or distribution by the Seller of the electricity whose consumption gave rise to the FTA Collections that are used to make distributions on the Certificates. If a court were to adopt this position, the result could initially be a reduction in the amounts paid to the Note Issuer, and thus to the holders of the Certificates. The FTA Charges may be adjusted through True-Up Mechanism Advice Letters, although delays in implementation thereof may cause delays or reductions in receipt of scheduled distributions.

Regardless of whether the Seller is the debtor in a bankruptcy case, if a court were to accept the arguments of a creditor of the Seller that Transition Property comes into existence only as Customers use electricity, a tax or government lien or other nonconsensual lien on property of the Seller arising before the Transition Property came into existence may have priority over the Note Issuer's interest in such Transition Property, thereby possibly initially resulting in a reduction of amounts distributed to the holders of the Certificates. The FTA Charges may be adjusted through True-Up Mechanism Advice Letters, although delays in implementation thereof may cause a delay in receipt of scheduled distributions.

Potential Bankruptcy of Servicer

For so long as the Servicer maintains a short-term debt rating of at least "A-1" by Standard & Poor's, a division of The McGraw-Hill Companies, Inc. ("S&P") and "P-1" by Moody's Investors Service, Inc. ("Moody's") or certain other conditions are satisfied, the Servicer is entitled to commingle FTA Payments with its own funds until the relevant Remittance Date. In the event of a bankruptcy of the Servicer, the Note Trustee likely will not have a perfected interest in such commingled funds and the inclusion thereof in the bankruptcy estate of the Servicer may result in delays in distributions due on the Certificates. Furthermore, if the Servicer is in bankruptcy, it may stop performing its functions as Servicer and it may be difficult to find a third party to act as successor Servicer. See "*—Potential Servicing Issues—Reliance on Servicer*" herein.

Potential Bankruptcy of Infrastructure Bank

The Infrastructure Bank is a public body established within the state government of the State of California. The State of California cannot be a debtor in a case under the Bankruptcy Code. If a court were to determine that the Infrastructure Bank is an "instrumentality" of the State, rather than an integral part of the State, then the Infrastructure Bank could become a debtor in a case commenced under Chapter 9 of the Bankruptcy Code if the requirements set forth in the Bankruptcy Code for the commencement of a voluntary case under Chapter 9 were met. An involuntary case cannot be commenced against the Infrastructure Bank under Chapter 9 and neither a voluntary nor an involuntary case can be commenced by or against the Infrastructure Bank under any other chapter of the Bankruptcy Code.

The Certificates will be issued by the Trust, which is a business trust formed by the Infrastructure Bank under Title 12, Chapter 38 of the Laws of the State of Delaware (the "Delaware Business Trust Act"). The Trust may be subject to a voluntary or involuntary case under the Bankruptcy Code. However, the Trust will be created solely to issue and administer the Certificates, and the only assets of the Trust will consist of the Notes and the right to receive payments under any Swap Agreement. The Trust and the Infrastructure Bank have taken steps to minimize the risk that in the event the Infrastructure Bank becomes a debtor in a case under Chapter 9 of the Bankruptcy Code, a bankruptcy court having jurisdiction over such case should not order that the assets

and liabilities of the Trust be substantively consolidated with those of the Infrastructure Bank. These steps include (a) creating the Trust as a separate business trust under the Delaware Business Trust Act which includes provisions preventing creditors of the Infrastructure Bank from having any right to the assets of the Trust, (b) limiting interaction between the Infrastructure Bank and the Trust, (c) maintaining accounting, bookkeeping, business forms and financial statements for the Trust separate from those of the Infrastructure Bank, and (d) restricting the nature of the Trust's business and its ability to commence a voluntary case under the Bankruptcy Code.

Nature of the Certificates

Limited Liquidity

There is no assurance that a secondary market for any of the Certificates will develop or, if one does develop, that it will provide the Certificateholders with liquidity of investment or that it will continue for the life of such Certificates. It is not anticipated that any Certificates will be listed on any securities exchange.

Restrictions on Book-Entry Registration

The Certificates will be initially represented by one or more Certificates registered in Cede's name, as nominee for DTC, and will not be registered in the names of the Certificateholders or their nominees. Therefore, unless and until Definitive Certificates are issued, Certificateholders will not be recognized by the Certificate Trustee as Certificateholders. Hence, until such time, Certificateholders will only be able to receive distributions from, and exercise the rights of Certificateholders indirectly through, DTC and participating organizations, and, unless a Certificateholder requests a copy of any such report from the Certificate Trustee or the Servicer, will receive reports and other information provided for under the Servicing Agreement only if, when and to the extent provided to Certificateholders by DTC and its participating organizations. In addition, the ability of Certificateholders to pledge Certificates to persons or entities that do not participate in the DTC system, or otherwise take actions in respect of such Certificates, may be limited due to the lack of physical certificates for such Certificates. See "Description of the Certificates—Book-Entry Registration" herein.

Limited Obligations

Neither the Notes nor the Certificates will represent an interest in or obligation of the Seller, the State of California or the Infrastructure Bank. The Transition Property owned by the Note Issuer and the other Note Collateral, which is expected to be relatively small, are the sole source of payments on the Notes. It is anticipated that the Note Collateral, which is described under "Description of the Notes—Security" herein, will with limited exceptions specified therein constitute the Note Issuer's only asset. The Note Issuer's organizational documents will restrict its right to acquire other assets unrelated to the transactions described herein. The Notes are limited obligations of the Note Issuer, and are the sole assets of the Trust other than the Trust's rights under any Swap Agreement. The Certificates represent fractional undivided beneficial interests in the related Class of Notes held by the Trust, and the sole source of distributions thereon is the payments on such Notes and, for Floating Rate Certificates, the proceeds of any Swap Agreement. If distributions are not made on the Certificates in a timely manner as a result of nonpayment of the related Notes, the Certificateholders may direct the Certificate Trustee to bring an action against the Note Issuer to foreclose upon the Transition Property and the other Note Collateral securing the Notes and, if the Certificate Trustee fails to bring such action, the Certificateholders may bring such an action themselves, as described under "Description of the Certificates—Events of Default" herein. If the Swap Contemporary fails to remit payment of Net Trust Swap Receipts, the interest rate on the related Floating Rate Certificates will convert to a fixed rate equal to the rate on the related Class of Notes effective as of the Distribution Date immediately preceding such default. None of the Certificates, the Notes or the underlying Transition Property will be guaranteed or insured by the State of California, the Infrastructure Bank, the Trust or any other governmental agency or instrumentality or by the Seller or its affiliates. Neither the full faith and credit nor the taxing power of the State of California is pledged to the payment of principal of or interest on the Certificates or the Notes or payments in respect of the Transition Property.

Issuance in Series

The Note Issuer expects to issue new Series of Notes from time to time, and accordingly the Trust is expected to issue new corresponding Series of Certificates from time to time. While the terms of any Series of Notes and the corresponding Series of Certificates will be specified in supplements to the Note Indenture and the Trust Agreement, respectively, and described in the related Prospectus Supplement, the provisions of supplements to the Note Indenture and the Trust Agreement and, therefore, the terms of any new Series, will not be subject to the prior review or consent of holders of the Notes or Certificates of any previously issued Series. The terms of a new Series of Certificates may include without limitation the matters described under "Description of the Certificates—General" herein. The ability of the Trust to issue any new Series of Certificates is subject to the condition, among others, that such issuance will not result in any Rating Agency reducing or withdrawing its then existing rating of the Certificates of any outstanding Class. There can be no assurance, however, that the issuance of any other Series of Certificates, including any Series issued from time to time hereafter, might not have an impact on the timing or amount of distributions received by a Certificateholder. See "Description of the Certificates—Conditions of Issuance of Additional Series" herein. In addition, various matters relating to the Certificates are subject to a vote of all Certificateholders for all Series and Classes of Certificates, even though there may be differences in the interests or positions among such Series or Classes which could result in voting outcomes adverse to the interests of one or more Series or Classes of Certificates.

Limited Nature of Ratings

It is a condition of issuance of each Class of Certificates that they receive from the Rating Agencies the respective ratings set forth in the applicable Prospectus Supplement. The ratings of the Certificates address the likelihood of the ultimate distribution of principal and the timely distribution of interest on the Certificates. The ratings do not represent an assessment of the likelihood that the rate of FTA Collections might differ from that originally anticipated; as a result of such differences, any Series or Class of Certificates might mature later than scheduled, resulting in a weighted average life of such Certificates which is more than expected. A security rating is not a recommendation to buy, sell or hold securities. There can be no assurance that a rating will remain in effect for any given period of time or that a rating will not be revised or withdrawn entirely by a Rating Agency if, in its judgment, circumstances so warrant.

Uncertain Distribution Amounts and Weighted Average Life

The actual dates on which principal is paid on each Class of Certificates might be affected by, among other things, the amount and timing of receipt of FTA Collections. Since each FTA Charge will consist of a charge per kilowatt hour of usage by the applicable class of Customers in the Territory, the aggregate amount and timing of receipt of FTA Collections (and the resulting amount and timing of principal amortization on the Certificates) will depend, in part, on actual usage of electricity by Customers and the rate delinquencies and write-offs. See "—Potential Servicing Issues—Inaccurate Usage and Credit Projections" herein. Although the amount of the FTA Charges will adjust from time to time based in part on the actual rate of FTA Collections, no assurances can be given that the Servicer will be able to forecast accurately actual Customer energy usage and the rate of delinquencies and write-offs and implement adjustments to the FTA Charges that will cause FTA Payments to be made at any particular rate. If FTA Collections are received at a slower rate than expected, distributions on a Certificate may be made later than expected. Because principal will only be distributed at a rate not to exceed that set forth in the Expected Amortization Schedules, except in the event of an early redemption, the Certificates are not expected to be retired earlier than scheduled. A distribution on a date that is earlier than forecasted will result in a shorter weighted average life, and a distribution on a date that is later than forecasted will result in a longer weighted average life. See "Certain Distribution, Weighted Average Life and Yield Considerations" and "Description of the Transition Property—Adjustments to the FTA Charges" herein.

Effect of Optional Redemption on Weighted Average Life and Yield

As described more fully under "Description of the Notes—Optional Redemption" herein, the Note Issuer has the option to redeem all of the outstanding Notes of any Series on any Payment Date if, after giving effect to payments that would otherwise be made on such date, the outstanding principal balance of such Series of Notes has been reduced to less than five percent of the initial outstanding principal balance thereof. Redemption of a Series of Notes will require the Certificate Trustee to redeem the related Series of Certificates. Redemption will cause such Certificates to be retired earlier than would otherwise be expected, and if the payment schedule otherwise does not differ from that originally anticipated, will result in a shorter than expected weighted average life for such Certificates. Such a redemption may also adversely affect the yield to maturity of the Certificates. There can be no assurance as to whether the Note Issuer will exercise the option to redeem any Series of Notes, or as to whether Certificateholders will be able to receive an equally attractive rate of return upon reinvestment of the proceeds resulting from any such redemption.

Additional Risks of Floating Rate Certificates

As described herein under "Description of the Certificates—Floating Rate Certificates," upon the occurrence of an event of default or termination event, the Swap Agreement pursuant to which interest will be paid on any Floating Rate Certificates will terminate or may be terminated. In particular, the Swap Agreement will be terminated if the Swap Counterparty's rating by either of Moody's or S&P falls below "AAA" (or the equivalent rating) (a "Downgrade Event") and the Swap Agreement is not assigned to a replacement swap counterparty satisfying such ratings criteria or such lower ratings criteria as may be permitted by the Swap Agreement within the time period specified in the related Prospectus Supplement. In no event will any successor swap counterparty, be rated below "A" (or the equivalent rating) by either of the above-referenced Rating Agencies. Upon the occurrence of a Downgrade Event and the failure to assign the Swap Agreement, an event of default will have occurred under the Swap Agreement and, in such event or upon any other swap termination, the interest rate payable with respect to the Floating Rate Certificates will convert permanently to a fixed rate equal to the interest rate on the related Class of Notes, which may be substantially less than the rate otherwise payable on the Floating Rate Certificates. In the event of such conversion to a fixed interest rate, both the liquidity and the market value of the Floating Rate Certificates may be adversely affected.

DESCRIPTION OF THE TRANSITION PROPERTY

General

In September 1996, legislation implementing an electric industry restructuring program for the State of California became law. The Statute was adopted to provide, among other things, for the issuance of "rate reduction bonds" which are the Certificates issued hereunder, and a ten percent reduction in rates for services charged to Residential Customers and Small Commercial Customers, effective as of January 1, 1998 and generally continuing until the earlier of March 31, 2002 or the date on which Transition Costs have been fully recovered (the "Rate Freeze Period"). As part of the Statute, Sections 367 and 369 of the PU Code provide the Seller an opportunity to recover the Transition Costs. The Transition Costs consist of the costs of generation-related assets and obligations that may become uneconomic as a result of a competitive generation market, together with costs for capital additions to generating facilities that the CPUC determines to be reasonable, costs of refinancing or retiring of debt or equity capital, and associated federal and state tax liabilities. Examples of generation-related assets include generation facilities, amounts recoverable in electric rates pursuant to settlement agreements with the CPUC in connection with nuclear power plants, power purchase contracts with third-party generators of electricity (including voluntary restructuring, renegotiations or terminations thereof) and generation-related regulatory assets. Generation-related regulatory assets are those "regulatory assets" whose origin can be attributed to the generation portion of a utility's business. "Regulatory assets" reflect incurred costs that otherwise would have been expensed, but have been capitalized because it is probable that such costs will be recovered in future rates. All of the foregoing generation-related assets may become uneconomic in a competitive generation market, since they are obligations that were undertaken either pursuant to legal requirements or with the understanding that they would be recoverable in rates approved by the CPUC. Since other participants in a competitive market, unburdened by these uneconomic assets, may be able to offer electricity at lower rates, the costs relating to these uneconomic assets may not be recoverable in market prices in a competitive market.

The Statute provides for the creation of the Transition Property, which is the right to be paid the FTA Payments based on the FTA Charges in order to recover a portion of the Transition Costs. The Seller has estimated its total Transition Costs to be as much as \$12 billion, and the Financing Order authorizes the issuance of up to \$3 billion of Certificates.

Financing Order and Advice Letters

The Statute authorizes the CPUC to issue the Financing Order, a regulatory order which allows the Seller to reduce electricity rates for the Customers by ten percent, and approves the amount of the Seller's Transition Costs which the Seller is permitted to finance through the issuance of rate reduction bonds. On May 6, 1997, Edison filed its application for the Financing Order with the CPUC. The CPUC issued the Financing Order dated September 3, 1997. The Financing Order also permits the sale of Certificates in an aggregate principal amount not to exceed \$3,000,000,000. As issued, the Financing Order also requires the Seller to reduce electricity rates for the Customers by ten percent through the Rate Freeze Period. The principal amount of the Certificates approved in the Financing Order was calculated so as to result in a reduction in revenue requirements for the Seller sufficient to enable the Seller to provide the ten percent rate reduction and to enable the owner of Transition Property to pay interest on and principal of the Certificates, together with related fees and expenses, including the Overcollateralization Amount. The principal amount of the Certificates was derived based upon a number of variables, including sales forecasts and the expected interest rate and amortization schedule for the Certificates. If estimated usage exceeds the assumptions used in the Financing Order, the Seller intends to request the authority to issue additional Certificates to support the rate reduction resulting from this increased usage. The issuance of additional Certificates will result in a corresponding increase in the FTA Charges, and thus in the amounts payable with respect thereto by Customers. See "Description of the Certificates—Conditions of Issuance of Additional Series" herein.

The Financing Order, together with the applicable Issuance Advice Letter, establishes, among other things, the FTA Charges, which constitute separate nonbypassable charges payable by Residential Customers and Small

Commercial Customers in an aggregate amount sufficient to repay in full the Certificates, fund the Overcollateralization Subaccount and pay all related fees and expenses. The FTA Charges are stated to be nonbypassable on the basis that the Statute authorizes the Note Issuer, as the owner of the Transition Property, to continue to collect payments based on the FTA Charges from all Customers notwithstanding any of the circumstances described under “—Nonbypassable FTA Charges” below. The Statute provides that the right to collect payments based on the FTA Charges is a property right which may be pledged, assigned or sold in connection with the issuance of the Certificates. Under the Statute and the Financing Order, the owner of the Transition Property is entitled to collect FTA Charges until such owner has received FTA Collections sufficient to retire all outstanding Series of Certificates and cover related fees and expenses and the Overcollateralization Amount. The Customers consist of those persons whose service falls under the tariffs described below in “The Seller and Servicer—Edison Customer Base and Electric Energy Consumption.”

The Financing Order entitles the Note Issuer, as the owner of the Transition Property, to receive the payments made pursuant to the FTA Charges from all Residential Customers and Small Commercial Customers. Such payments are referred to herein as the FTA Payments. The Financing Order requires the Seller to submit an Issuance Advice Letter to the CPUC with respect to each Series of Certificates issued. The first Issuance Advice Letter will establish the initial FTA Charges. The Financing Order provides that Issuance Advice Letters become effective five business days after filing with the CPUC. Subsequent Issuance Advice Letters may increase the FTA Charges to support the issuance of additional Series of Certificates. The Financing Order permits the Servicer to file True-Up Mechanism Advice Letters to modify the FTA Charges from time to time, in order to enhance the likelihood of retirement of each Series and Class of Certificates on a timely basis. See “—Adjustments to the FTA Charges” herein.

The initial FTA Charges will be calculated by determining first (i) projected monthly electricity sales to the Customers and the timing and extent of receipt of payments therefor during the first year following the Closing Date and (ii) the required amounts to be covered by FTA Collections on a projected basis, including interest on the Notes, ongoing transaction expenses including the Servicing Fee, the related Overcollateralization Amount and scheduled principal payments on the Notes. Then, based on the figures determined for the two foregoing amounts, the lowest aggregate charges which will be adequate to cover all of the amounts to be covered by FTA Collections will be calculated (the “Base Calculation Model”). Because of differences in the tariff rate for each class of Customers, the FTA Charge payable by Residential Customers is expected to be different from the FTA Charge payable by Small Commercial Customers. The initial FTA Charges are expected to result in FTA Payments by Residential Customers and Small Commercial Customers representing approximately 83 percent and 17 percent, respectively, of the aggregate FTA Payments expected to be collected in 1998. The foregoing percentages may change from time to time based on fluctuations in Customer composition, electricity usage and delinquency and write-off rates.

The Prospectus Supplement related to a Series of Certificates will specify, based on the applicable Issuance Advice Letter, the amount of each of the FTA Charges as of the date thereof.

Transition Property

The right to be paid the FTA Payments gives rise to a separate property right under California law and is referred to herein generally as the “Transition Property.” “Transition Property” is defined more specifically in Section 840(g) of the PU Code as the property right created under the PU Code including, without limitation, the right, title and interest of an electrical corporation or its transferee (i) in and to the FTA Charges, as adjusted from time to time, (ii) to be paid the FTA Payments, and (iii) to obtain adjustments to the FTA Charges, as provided in the PU Code.

Each Class of Notes will be issued in connection with a specific issuance of a Class of Certificates. Each Note will be secured by Transition Property, as well as the other Note Collateral described under “Description of the Notes—Security” herein. Following the initial Issuance Advice Letter, each subsequent Issuance Advice

Letter will authorize the creation of additional Transition Property to support payments on the related Series or Class of Notes. Any additional Transition Property acquired by the Note Issuer pursuant to a Sale Agreement will be combined into a single asset with all other Transition Property acquired by the Note Issuer pursuant to previous Sale Agreements. Accordingly, the aggregate amount of Transition Property will increase as additional Issuance Advice Letters become effective.

Nonbypassable FTA Charges

The Financing Order provides that the FTA Charges are nonbypassable, meaning that Customers still will be required to make payments with respect to the applicable FTA Charges even if the Customer purchases power from a third party or if another entity takes over a portion of Edison's existing service territory. Each Customer who leaves Edison's system during the Rate Freeze Period through annexation by another electricity supplier will pay an ongoing charge based on the electricity usage of such Customer prior to annexation or the Customer's actual or estimated current consumption. In such events the applicable FTA Charge will be based on (i) the last twelve months of the Customer's recorded pre-departure use, (ii) an average derived from the last three years of recorded use or (iii) actual use. Small Commercial Customers whose usage increases to a level above what qualifies under the applicable tariffs for such customer class are not obligated to pay the FTA Charge. To the extent that Customers choose to purchase their electricity from ESPs that provide consolidated billing, the Note Issuer will be relying on a small number of ESPs, rather than a large number of Customers, to remit FTA Payments. Under these circumstances, a default in the payment of FTA Charges by a single ESP that provides electricity services to a large number of Customers may adversely affect the timing of payments on the Certificates. See "Servicing—Aggregators and Other Suppliers" herein. In addition, the Note Issuer expects that the applicable FTA Charge (which will be based on historic usage) could be imposed on certain Customers who self-generate their electricity; however, the ability of the Servicer to collect such FTA Charges may be limited because the Servicer will not have ready access to data about which consumers are self-generating and will not be able to exercise shut-off rights as an enforcement tool against a self-generator. Nevertheless, the Servicer's current forecasts of future electricity demand do not include any shift by Customers to self-generation, because self-generation of electricity by Customers is not expected to be economically viable during the period in which the Certificates will be outstanding.

Adjustments to the FTA Charges

In order to enhance the likelihood that the actual FTA Collections are neither more nor less than the amount necessary to amortize the Notes in accordance with the Expected Amortization Schedule, pay all related fees and expenses, fund the Overcollateralization Subaccount as scheduled and replenish the Capital Subaccount, the Servicing Agreement requires the Servicer to seek, and the Financing Order and the Statute require the CPUC to approve, periodic adjustments to the FTA Charges based on actual FTA Collections and updated assumptions by the Servicer as to future usage of electricity by Customers, future expenses relating to the Transition Property, the Notes and the Certificates, and the rate of delinquencies and write-offs. The date as of which any calculation is performed and which forms the basis for a requested adjustment to the FTA Charges is referred to as a "Calculation Date." The adjustments to the FTA Charges will continue until all interest and principal on all Series of Notes and corresponding Series of Certificates have been paid or distributed in full.

The Financing Order provides that the Servicer will file a routine True-Up Mechanism Advice Letter annually, requesting modifications to the FTA Charges which are intended to return the projected principal balance of each outstanding Series of Certificates to the amount provided for in the Expected Amortization Schedule within a twelve month period or, if earlier, by the Final Maturity Date. Modifications to the FTA Charges will also factor in any amount in the Reserve Subaccount available for distribution to Certificateholders and any amounts necessary within a twelve-month period: (i) to fund the Overcollateralization Subaccount up to the Required Overcollateralization Level and (ii) to the extent that withdrawals have been made from the Capital Subaccount, to ensure that the amount on deposit in the Capital Subaccount will equal the Required Capital Level.

Calculations of appropriate modifications to the FTA Charges will be made based on the Base Calculation Model, except that (i) the amount of debt service and related expenses including funding of the Overcollateralization Subaccount for the following year and replenishing the Capital Subaccount shall be increased or decreased to reflect the amount by which expected FTA Collections through the end of the month of calculation was less than or exceeded the aggregate actual portion of the debt service on the Certificates and related expenses for such period, (ii) forecasted electricity sales for the remaining period of the transaction will be revised based on the methodologies described in "The Seller and Servicer—Forecasting Consumption" herein, (iii) estimated transaction expenses will be modified to reflect changed circumstances, (iv) assumed delinquencies and write-offs will be modified to reflect changed circumstances and (v) an adjustment will be made to reflect any collections which are expected to be received at the existing levels of FTA Charges from the end of the month preceding the month of calculation through the end of the month in which the new FTA Charges become effective (the "True-Up Mechanism Calculation Model").

The Servicer may also file a routine True-Up Mechanism Advice Letter quarterly if so specified in the related Prospectus Supplement. Furthermore, the Financing Order provides that the Servicer may file a non-routine True-Up Mechanism Advice Letter as often as quarterly, to reflect any changes to the Base Calculation Model or True-Up Mechanism Calculation Model which are necessary to meet any Expected Amortization Schedule and fund the Capital Subaccount and Overcollateralization Subaccount as described above. Finally, the Statute requires the Servicer to file a True-Up Mechanism Advice Letter with the CPUC annually, prior to each anniversary of the issuance of the Financing Order (a "Financing Order Anniversary"); however, given the other routine filings required to be made, the Servicer does not intend to seek adjustments on each Financing Order Anniversary, unless necessary. True-Up Mechanism Advice Letters will take into account amounts available in the General Subaccount and Reserve Subaccount, and amounts necessary to fund the Overcollateralization Subaccount and the Capital Subaccount to required levels, in addition to amounts payable on the Notes.

The Servicing Agreement will require the Servicer to deliver a written copy of each True-Up Mechanism Advice Letter, together with a copy of all supporting calculations, to the Note Issuer, the Note Trustee, the Infrastructure Bank and the Certificate Trustee upon filing such True-Up Mechanism Advice Letter with the CPUC.

The Financing Order provides that (i) routine True-Up Mechanism Advice Letters shall be filed with the CPUC annually at least fifteen days before the end of each calendar year, with resulting adjustments to the FTA Charges to become effective at the beginning of the next calendar year, (ii) routine True-Up Mechanism Advice Letters may be filed with the CPUC quarterly at least fifteen days before the end of each calendar quarter, with resulting adjustments to the FTA Charges to become effective at the beginning of the next calendar quarter, (iii) non-routine True-Up Mechanism Advice Letters may be filed with the CPUC quarterly at least 90 days before the end of each calendar quarter, with resulting adjustments to the FTA Charges to become effective at the beginning of the next calendar quarter, and (iv) True-Up Mechanism Advice Letters shall be filed with the CPUC at least fifteen days before each Financing Order Anniversary, with resulting adjustments to the FTA Charges, if necessary, to become effective within 90 days of such Financing Order Anniversary.

Sale and Assignment of Transition Property

On the date on which the initial Series of Certificates is issued and sold (the "Closing Date"), pursuant to the Sale Agreement the Seller will sell and assign to the Note Issuer, without recourse, its entire interest in the Transition Property that is described in the first Issuance Advice Letter submitted by the Servicer (the "Initial Transition Property"). The net proceeds received by the Note Issuer from the sale of the Notes will be applied to the purchase of the Initial Transition Property. Thereafter the Seller may agree with the Note Issuer to sell additional Transition Property ("Subsequent Transition Property") to the Note Issuer, subject to the satisfaction of certain conditions. Such Subsequent Transition Property will be sold to the Note Issuer effective on a date (a "Subsequent Transfer Date") specified in the written agreement between the Seller and the Note Issuer. The Note Issuer will issue and sell additional Notes to the Trust, and the Trust will issue and sell additional Certificates, in connection therewith.

The Note Issuer will appoint the Servicer as custodian of the documentation relating to the Transition Property. The Seller's data systems will reflect the sale and assignment of the Transition Property to the Note Issuer. The Seller's financial statements will indicate that the Transition Property has been sold to the Note Issuer and will not be available to creditors, although for financial reporting purposes the Seller will treat the Transition Property as representing debt of the Seller.

Subsequent Transition Property may be sold by the Seller to the Note Issuer from time to time, solely in connection with the issuance and sale of additional Notes by the Note Issuer and of corresponding additional Certificates by the Trust. Any conveyance of Subsequent Transition Property is subject to the following conditions, among others:

- (a) the Seller shall have entered into a written sale agreement with the Note Issuer;
- (b) the Seller shall have filed an Issuance Advice Letter with the CPUC relating to such Subsequent Transition Property, which Issuance Advice Letter shall have become effective;
- (c) as of the applicable Subsequent Transfer Date, the Seller shall not be insolvent and shall not be made insolvent by such conveyance;
- (d) the Rating Agency Condition shall have been satisfied with respect to such conveyance;
- (e) such conveyance will not result in an adverse tax consequence to the Trust or the Certificateholders;
- (f) as of the applicable Subsequent Transfer Date, no breach by the Seller of its representations, warranties or covenants in the applicable Sale Agreement shall exist; and
- (g) as of the applicable Subsequent Transfer Date, the Note Issuer shall have sufficient funds available to pay the purchase price for the Subsequent Transition Property to be transferred on such date and all conditions to the issuance of new series of Notes and Certificates shall have been satisfied or waived.

Seller Representations and Warranties and Repurchase Obligation

In the initial Sale Agreement and each subsequent Sale Agreement, the Seller will make representations and warranties to the Note Issuer to the effect, among other things, that: (a) the information provided by the Seller to the Note Issuer with respect to the applicable Transition Property is correct in all material respects; (b) at the related Series Issuance Date, the applicable Transition Property is owned by the Seller and is free and clear of all security interests, liens, charges and encumbrances, no offsets, defenses or counterclaims exist or have been asserted or threatened with respect thereto and the Seller, in its capacity as Seller or Servicer, will not at any time assert any security interest, lien, charge or encumbrance against or with respect to any applicable Transition Property; (c) at the related Series Issuance Date, the applicable Transition Property has been validly transferred and sold to the Note Issuer and all filings (including filings with the CPUC under the PU Code) necessary in any jurisdiction to give the Note Issuer a first perfected ownership interest in the applicable Transition Property shall have been made; (d) under the laws of the State of California and the United States in effect on the Series Issuance Date (i) the Financing Order and each Issuance Advice Letter pursuant to which any applicable Transition Property has been created are in full force and effect; (ii) as of the issuance of the Certificates, the Certificates are entitled to certain protections provided in the PU Code and, accordingly, the Financing Order and the Issuance Advice Letter are not revocable by the CPUC; (iii) none of the State of California, the CPUC or the Infrastructure Bank may revoke, limit, alter or modify the Transition Property, the Financing Order or the Advice Letters, and all rights thereunder, in a manner adversely affecting the Noteholders, other than a temporary impairment necessary to advance an important public interest, until the Certificates are fully discharged unless adequate provision shall be made by law for the protection of the Certificateholders; (iv) the process by which the Financing Order and the resolutions of the Infrastructure Bank were approved and the Issuance Advice Letter was filed, and such order, resolutions and letter themselves, comply with all applicable laws, rules and regulations, and no court or other administrative body can, prior to the discharge in full of the Certificates unless adequate provision shall be made by law for the protection of the Certificateholders, order the revocation, limitation or other impairment of the Financing Order, the Issuance Advice Letter, the approving resolutions of

the Infrastructure Bank, the Transition Property or the FTA Charges or to enjoin the performance of any obligations thereunder; and (v) no other approval or filing with any other governmental body is required in connection with the creation of the Transition Property, except those that have been obtained or made; (e) the assumptions used in calculating the FTA Charges related to the applicable Transition Property are reasonable and made in good faith; (f) upon the effectiveness of the Issuance Advice Letter: (i) all of the Transition Property constitutes a current property right; (ii) the Transition Property includes, without limitation, (A) the right, title and interest in and to the FTA Charges, as adjusted from time to time, (B) the right to be paid the total amounts set forth in the Issuance Advice Letter, (C) the right, title and interest in and to all revenues, collections, claims, payments, money, or proceeds of or arising from the FTA Charges set forth in the Issuance Advice Letter, and (D) all rights to obtain adjustments to the FTA Charges pursuant to the Financing Order; and (iii) the holders of the Transition Property are entitled to recover the Transition Costs described in the Financing Order or the Issuance Advice Letter in the aggregate amount equal to the principal amount of the Notes and the Certificates, all interest thereon, the Overcollateralization Amount (as such term is defined in the Servicing Agreement) relating to the Notes and all related fees, costs and expenses in respect of the Notes and the Certificates until they have been paid in full; (g) the Seller is a corporation duly organized and in good standing under the laws of the State of California, with power and authority to own its properties and conduct its business as currently owned or conducted and to execute, deliver and perform the terms of the Sale Agreement; (h) the execution, delivery and performance of the Sale Agreement have been duly authorized by the Seller by all necessary corporate action; (i) the Sale Agreement constitutes a legal, valid and binding obligation of the Seller, enforceable against the Seller in accordance with its terms; (j) the consummation of the transactions contemplated by the Sale Agreement do not conflict with the Seller's articles of incorporation or bylaws or any material agreement to which the Seller is a party or bound, result in the creation or imposition of any lien upon the Seller's properties or violate any law or any order, rule or regulation applicable to the Seller; (k) no governmental approvals, authorizations or filings are required for the Seller to execute, deliver and perform its obligations under the Sale Agreement except those which have previously been obtained or made; and (l) except as disclosed to the Note Issuer, no court or administrative proceeding or investigation is pending or, to the Seller's knowledge, threatened (i) asserting the invalidity of, or seeking to prevent the consummation of the transactions contemplated by, the Sale Agreement, the Note Indenture, the Trust Agreement or any of the other Basic Documents, (ii) seeking a determination that might materially and adversely affect the performance by the Seller of its obligations thereunder, or (iii) which might adversely affect the federal or state income tax attributes of the Notes or the Certificates.

In the event of a breach by the Seller of any representation specified in clause (d) or clause (f) above that has a material adverse effect on the Certificateholders, the Seller shall be obligated to repurchase the Transition Property from the Note Issuer at a purchase price equal to the outstanding principal amount of the Notes and all accrued and unpaid interest thereon as of the date that is five Certificate Business Days after the repurchase date (the "Repurchase Price"); provided, however, that the Seller shall not be obligated to repurchase the Transition Property if (A) within 90 days after the date of the occurrence thereof such breach is cured or the Seller takes remedial action such that there is not and will not be a material adverse effect on the Certificateholders as a result of such breach and (B) the Seller either (i) if the Seller had, immediately prior to the breach, a long term debt rating of at least "BBB-" or the equivalent by each of the Rating Agencies immediately prior to the breach and enters into a binding agreement with the Note Issuer to pay any amounts necessary so that all interest payments due on the Notes during such 90-day period will be paid in full or (ii) if the Seller does not have such long term debt ratings, deposits, within two business days of such breach, an amount in escrow with the Note Trustee sufficient to pay all interest payments, taking into account amounts available in the Collection Account, which will become due on the Notes during such 90-day period, which will be used by the Note Trustee to make such interest payments if there are not sufficient funds otherwise available therefor. The Sale Agreement will provide that any change in the law by legislative enactment, constitutional amendment or voter initiative that renders any of the foregoing representations untrue would not constitute a breach under the Sale Agreement.

In the event of a breach by the Seller of any other representation or warranty specified in clauses (b), (c), (g), (h), (i) or (j) above, if, within 30 days after the Seller receives written notice from the Note Trustee or the

Certificate Trustee or otherwise becomes aware of such breach, such breach has not been cured and the Seller has not taken remedial action such that there is not and will not be a material adverse effect as a result of such breach then the Seller shall be required to repurchase the Transition Property for the Repurchase Price. Upon the payment by the Seller of the Repurchase Price, no person shall have any other claims, rights or remedies against the Seller for a breach of the foregoing representations and warranties. In the event of a breach of any other representation or warranty of the Seller specified above, the Seller shall be required to indemnify, defend and hold harmless the Note Issuer, the Trust, the Noteholders, the Note Trustee, the Delaware Trustee, the Certificate Trustee, the Certificateholders, the California State Treasurer's Office (the "STO"), as agent for sale, and the Infrastructure Bank against any costs, expenses, losses, claims, damages and liabilities incurred as a result of such breach. The Seller will also agree to take any legal or administrative action, including defending against or instituting and pursuing legal actions, as may be reasonably necessary to protect the Note Issuer and the Certificateholders from claims, state actions or other actions or proceedings of third parties which, if successfully pursued would result in a breach of any representation described above.

CERTAIN DISTRIBUTION, WEIGHTED AVERAGE LIFE AND YIELD CONSIDERATIONS

The rate of principal distributions on each Class of Certificates, the aggregate amount of each interest distribution on each Class of Certificates and the actual maturity date of each Class of Certificates will be related to the rate and timing of receipt of FTA Collections. Accelerated receipts of FTA Collections will not result in principal distributions on the Certificates earlier than the Scheduled Maturity Dates since receipts in excess of the amounts necessary to amortize the Certificates in accordance with the applicable Expected Amortization Schedule will be deposited in the Reserve Subaccount for distribution in accordance with such schedule. However, delayed receipts of FTA Collections may result in principal distributions on the Certificates that occur later than the related Scheduled Maturity Dates.

The actual distributions on each date for each Class of Certificates and the weighted average life thereof will be affected primarily by the rate of FTA Collections and the timing of receipt of such FTA Collections, as well as amounts available in the Reserve Subaccount, the Overcollateralization Subaccount and the Capital Subaccount. Since each FTA Charge will consist of a charge per kilowatt hour of usage by the applicable class of Customers, the aggregate amount of FTA Collections and the rate of principal amortization on the Certificates will depend, in part, on actual energy usage by Customers and the rate of delinquencies and write-offs. Although the amounts of the FTA Charges will be adjusted from time to time based in part on the actual rate of FTA Collections, no assurances are given that the Servicer will be able to forecast accurately actual electricity usage and the rate of delinquencies and write-offs or implement adjustments to the FTA Charges that will cause FTA Collections to be received at any particular rate. See "Risk Factors—Unusual Nature of the Transition Property" and "Description of the Transition Property—Adjustment to the FTA Charges—Reliance on FTA Adjustments" herein. If FTA Collections are received at a slower rate than expected, a Certificate may be retired later than expected. Because principal will only be distributed at a rate not faster than that contemplated in the Expected Amortization Schedules, except in the event of an early redemption or the acceleration of the maturity of the Certificates after an Event of Default, the Certificates are not expected to mature earlier than scheduled. A distribution on a date that is earlier than forecasted will result in a shorter weighted average life, and a distribution on a date that is later than forecasted will result in a longer weighted average life. In addition, if a larger portion of the delayed distributions on the Certificates are received in later years, this will result in a longer weighted average life of the Certificates.

No assurances are given that the representations made herein and in the Prospectus Supplement as to the particular factors that will affect the rate of FTA Collections, the relative importance of such factors, the percentage of the principal balance of the Certificates that will be distributed as of any date or the overall rate of FTA Collections will be realized.

In addition, the Note Issuer has the option to redeem all of the outstanding Notes of any Series on any Payment Date if, after giving effect to payments that would otherwise be made on such date, the outstanding principal balance of such Series of Notes has been reduced to less than five percent of the initial outstanding principal balance thereof. Redemption of a Series of Notes will require the Certificate Trustee to redeem the

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PECO Statement No. 23-E *etal*

*Phila 11/19/97
E.H.*

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

APPLICATION OF PECO ENERGY COMPANY
FOR APPROVAL OF ITS RESTRUCTURING PLAN
UNDER SECTION 2806 OF THE PUBLIC UTILITY CODE

TESTIMONY
OF
JAMES W. SHARPE
REGARDING THE ENRON CHOICE PLAN

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Regarding the Petition of
Enron Energy Service Power, Inc.
for Approval of Enron's "Choice Plan"

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FOLDER

November 7, 1997

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TESTIMONY OF JAMES W. SHARPE

I. QUALIFICATIONS

Q. Please state your name and business address.

A. My name is James W. Sharpe. My business address is 1100 Campanile Building, 1155 Peachtree Street, Atlanta, Georgia 30309-3630.

Q: Have you testified previously in this matter?

A: Yes. On July 18, 1997, I submitted rebuttal testimony (PECO Statement No. 23-R). A statement of my qualifications is contained in my rebuttal testimony.

II. PURPOSE OF TESTIMONY AND SUMMARY CONCLUSIONS

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

A. There are two purposes of my testimony. First, I will describe the federal income tax rulings requested by PECO Energy, in connection with the intended securitization transaction, in its Private Letter Ruling Request submitted to the National Office of the Internal Revenue Service (the "IRS") in March of 1997 and the critical importance to PECO Energy of obtaining such rulings. Second, I will describe the potential adverse impact of the Enron Plan on the federal income tax rulings requested by PECO Energy.

1 **Q. Please summarize your conclusions.**

2 A. There are significant differences between the PECO Energy securitization plan and
3 the Enron Plan that, in my opinion, would prevent PECO Energy from obtaining a
4 favorable private letter ruling from the IRS on the Enron Plan. Specifically, I believe
5 that the IRS would view the Enron Plan as a fully taxable sale by PECO Energy of
6 the Intangible Transition Property to the grantor trust formed by Enron to purchase
7 the Transition Bonds. If the transaction were viewed in this manner, PECO Energy
8 would be subject to an immediate income tax liability of over \$2.250 billion at the
9 time the Transition Bonds were sold to the grantor trust. In my opinion, it would be
10 imprudent for PECO Energy to proceed with the securitization transaction under the
11 Enron Plan under these circumstances. In contrast, I believe that PECO Energy will
12 be able to obtain a favorable private letter ruling from the IRS for its securitization
13 plan which will eliminate all of the material federal and Pennsylvania income tax risks
14 of securitization under the Partial Settlement.

15
16 **III. THE PECO ENERGY IRS RULING REQUEST**

17
18 **Q. Please describe the securitization transaction PECO Energy may undertake under**
19 **the Partial Settlement.**

20 A. PECO Energy will transfer Intangible Transition Property and its related right to
21 collect Intangible Transition Charges ("ITC") to a wholly owned Delaware business
22 trust (the "SPE"), which for federal income tax purposes will be treated as a division
23 of PECO with no separate tax identity. The SPE will issue Transition Bonds, the

1 proceeds of which will flow through to PECO Energy. PECO Energy will collect the
2 ITC from customers based on their usage of electricity and transfer the ITC collected
3 to the SPE to make principal and interest payments on the Transition Bonds.
4

5 **Q. What are the principal federal income tax issues?**

6 A. There are two principal federal income tax issues. The first issue is whether PECO
7 Energy's transfer of the Intangible Transition Property and related ITC to the SPE
8 followed by the issuance of the Transition Bonds secured by the Intangible Transition
9 Property and the related ITC will be treated as a financing transaction. The real
10 concern is whether PECO Energy has sold the Intangible Transition Property and
11 related ITC to the Transition Bondholders or has merely pledged its rights to the
12 Transition Bondholders as security for the SPE's obligation to pay principal and
13 interest. The second issue is whether PECO Energy will be permitted to include the
14 ITC in its gross income as utility services are provided to customers rather than at
15 such earlier time as the Public Utility Commission ("PUC") declares its qualified rate
16 order to be irrevocable.
17

18 **Q. What will be the tax consequences to PECO Energy if the IRS refuses to issue
19 either or both of the requested tax rulings?**

20 A. If the IRS refuses to issue either or both of the requested tax rulings, there could be
21 disastrous tax consequences to PECO Energy and to the overall securitization
22 transaction. If the transaction is considered a taxable sale of PECO Energy's right to
23 receive future ITC from the customers or PECO Energy is required to accrue the

1 future stream of ITC at the time the qualified rate order becomes irrevocable, then
2 PECO Energy would be forced to pay federal and Pennsylvania income taxes at a
3 combined effective rate of 41.4% at the time the securitization is effected rather than
4 as the ITC is received from the customers. In either case, the acceleration of PECO
5 Energy's tax liability would impose a prohibitive cost on the securitization
6 transaction. In my opinion, securing a favorable IRS private letter ruling in a
7 transaction of this magnitude and involving such difficult tax issues on which there is
8 virtually no direct precedent is absolutely critical.

9
10 **Q. Please describe the federal income tax rulings requested by PECO Energy, in**
11 **connection with the intended securitization transaction, in its private letter ruling**
12 **request submitted to the National Office of the IRS in March of 1997.**

13 A. PECO Energy has requested rulings from the IRS that: (1) PECO Energy's transfer
14 of the Intangible Transition Property and related ITC to the SPE and the issuance of
15 the Transition Bonds will be treated as a financing transaction rather than as a taxable
16 sale of the Intangible Transition Property and related ITC for federal income tax
17 purposes; and (2) PECO Energy will be permitted to include the ITC in its gross
18 income as utility services are provided to customers rather than at such earlier time as
19 the PUC declares its qualified rate order irrevocable.

20
21 **Q. Why do taxpayers request private letter rulings from the IRS?**

22 A. The taxpayer wants assurance that the characterization of the transaction contained in
23 the private letter ruling will be binding on the IRS.

1 **Q: What will be the tax consequences to PECO Energy if the IRS agrees to issue the**
2 **requested tax rulings?**

3 A: If the IRS agrees to issue the requested tax rulings, PECO Energy will not have to
4 recognize the Transition Bond proceeds as income when received and will be
5 permitted to include the ITC in gross income as utility services are provided to
6 customers rather than at such earlier time as the PUC declares its qualified rate order
7 to be irrevocable. Consequently, all of the material income tax risks associated with
8 the securitization transaction will be eliminated.

9
10 **Q. Prior to the introduction of the Enron proposal, what were PECO Energy's**
11 **expectations regarding a favorable outcome of its ruling request?**

12 A. PECO Energy's ruling request is currently under review by the Financial Institutions
13 and Products and the Income Tax and Accounting Divisions of the National Office of
14 the IRS. Prior to the introduction of the Enron proposal, expectations of a favorable
15 outcome were high based on similar rulings issued by the IRS in early
16 September, 1997 to three California utilities, who requested such rulings based on the
17 California electric competition legislation. The California electric competition
18 legislation parallels the Pennsylvania electric competition legislation, and the
19 California securitization plan employed by their utilities is quite similar to PECO
20 Energy's securitization plan. These rulings say, in effect, that for federal income tax
21 purposes the proposed securitization transactions will constitute financings and
22 therefore the California utilities will not have to pay any income tax on the proceeds

1 from securitization and they will not have to accrue income at the time the PUC
2 enters the irrevocable rate order.

3
4 **Q. Have you obtained a copy of the California tax rulings?**

5 A. No. They have not been published by the IRS and the California utilities have not
6 shared copies with other utilities and their professional advisors.

7
8 **Q. May PECO Energy rely on the California rulings?**

9 A. No, only the taxpayer to whom a private letter ruling is issued may rely on the ruling
10 it received. Therefore, PECO Energy is required to obtain its own private letter
11 ruling from the IRS if it wishes to obtain assurances that its securitization transaction
12 will be reportable for tax purposes in the manner PECO Energy desires.

13
14 **Q. If PECO Energy obtains a favorable ruling from the IRS, will it also be binding
15 on the Pennsylvania Department of Revenue (the "DOR")?**

16 A. As a practical matter, yes. The Pennsylvania corporate net income tax is imposed on
17 a taxpayer's taxable income as *finally determined* for federal income tax purposes,
18 subject to certain adjustments. Therefore, if PECO Energy obtains a favorable ruling
19 on the securitization transaction from the IRS, the Pennsylvania DOR will be bound
20 by that ruling.

21
22 **Q. Can you describe some of the more important concerns expressed by the IRS in
23 connection with its issuance of favorable tax rulings to the California utilities?**

1 A. The overriding concern is whether the SPE will maintain a significant equity interest
2 in the Intangible Transition Property and the related ITC. In other words, the IRS
3 will analyze closely all of the facts and circumstances surrounding the securitization
4 transaction to determine whether the SPE has merely pledged the Intangible Transition
5 Property and related ITC as security for the payment of principal and interest on the
6 Transition Bonds (as in a financing), or whether the Transition Bondholders have, in
7 substance, acquired the benefits and assumed the burdens of ownership associated
8 with the Intangible Transition Property and the related ITC (as in a sale). If the
9 transaction is treated as a sale, the SPE is merely a conduit for the collection of the
10 ITC as agent for the Transition Bondholders - i.e., the transaction is merely a
11 "pay-through" of the ITC from the customers to the Transition Bondholders.

12
13 The IRS is not willing to rule favorably on a securitization transaction unless the SPE
14 is projected to maintain a significant equity interest in the Intangible Transition
15 Property and the related ITC throughout the life of the Transition Bonds and is not
16 merely a conduit designed to effect a straight "pay-through" of the ITC from the
17 customers to the Transition Bondholders. If there is a direct "pay-through," the IRS
18 likely will refuse to rule favorably, in effect finding that the ITC has been sold to the
19 Transition Bondholders at the time that the securitization transaction is effected.
20 Thus, the discontinuity of the receipt of ITC by the SPE and the payment of principal
21 and interest on the Transition Bonds is an essential precondition to the conclusion that
22 the SPE, rather than the Transition Bondholders, owns the Intangible Transition
23 Property and the related ITC.

1 Q. Please describe the principal requirements to establish that the transaction does
2 not constitute a straight "pay-through" of ITC received by the SPE to the
3 Transition Bondholders such that the SPE will be treated by the IRS as the
4 owner of the Intangible Transition Property and the related ITC.

5 A. There are really four essential requirements, the absence of any of which would
6 imperil PECO Energy's ability to obtain a favorable tax ruling from the IRS.

7
8 First, PECO Energy must make a capital contribution in money equal to at least 50
9 basis points (0.5%) of the principal amount of Transition Bonds issued by the SPE.
10 This capital contribution may not be loaned by the SPE to PECO Energy or any of its
11 affiliates and must be available to the Transition Bondholders in the event that the
12 ITC collected by PECO Energy and transferred to the SPE is insufficient to timely
13 pay all principal and interest on the Transition Bonds. This requirement ensures that
14 the SPE will possess a significant amount of equity which is at risk throughout the life
15 of the Transition Bonds, thereby demonstrating that the SPE has its own money at
16 risk.

17
18 Second, the projected ITC, including any true-ups, must be sufficient to not only
19 timely pay principal and interest on the Transition Bonds as they become due, but
20 also to permit the SPE to build up an overcollateralization reserve ratably over the life
21 of the Transition Bonds in an aggregate amount equal to at least 50 basis points
22 (0.5%) of the principal amount of the Transition Bonds. This requirement ensures
23 that there will be a further build-up of the SPE's equity over the life of the Transition

1 Bonds. On the other hand, the absence of a material build-up in the equity of the
2 SPE is an indication that it does not possess an equity stake in the Intangible
3 Transition Property and related ITC.

4
5 Third, the Transition Bonds must provide a fixed schedule of principal payments due
6 over the life of the bonds and the Transition Bonds may not be callable prior to their
7 scheduled maturities, except for a so-called "clean-up" call made after at least 95% of
8 the aggregate principal amount of the Transition Bonds has been repaid by the SPE.
9 This requirement ensures that the SPE cannot use overcollections of ITC to fund early
10 redemptions of the Transition Bonds, thereby further demonstrating that the SPE has
11 an economic interest in the Intangible Transition Property and related ITC.

12
13 Fourth, debt service on the Transition Bonds should be payable on a quarterly or
14 semiannual basis, rather than on a monthly basis. This requirement ensures that the
15 receipt of ITC by the SPE will not be matched by an immediate or almost immediate
16 "pay-through" of substantially all of the ITC to the bondholders.

17
18 In summary, all of these requirements are designed to give substance to the claim by
19 the SPE that it possesses a real economic interest in the Intangible Transition Property
20 and related ITC that is distinguishable from the interest the Transition Bondholders
21 possess as secured creditors.

1 **IV. THE EFFECT OF THE APPROVAL OF THE ENRON PLAN**
2 **ON THE PECO ENERGY IRS RULING REQUEST**
3
4

5 **Q. In the context of obtaining a favorable private letter ruling from the IRS, how**
6 **does the Enron Plan differ from PECO Energy's securitization plan?**

7 **A. The Enron Plan differs in a number of ways from PECO Energy's securitization plan**
8 **which in my opinion will be critical to the IRS in deciding whether to issue a**
9 **favorable private letter ruling. These include:**

10 1. The ITC received by the SPE will be insufficient to pay principal and
11 interest on the Transition Bonds and to fund the overcollateralization reserve.
12 Indeed, within two months after the Transition Bonds are issued, the SPE's
13 aggregate deficit cash flow will exceed its initial capitalization.

14 2. Under the Enron Plan, the Transition Bonds will be issued at a stated
15 interest rate of 9.66% rather than at a market rate (presently about 6.5%) and
16 sold to the grantor trust at par. As a consequence, the grantor trust acquires
17 the Transition Bonds at a purchase price that is approximately \$1 billion less
18 than the fair market value of the Transition Bonds.

19 3. The principal amount of Transition Bonds to be issued under the Enron
20 Plan will equal 100% of PECO Energy's \$5.461 billion of stranded assets,
21 whereas PECO Energy would securitize not more than \$4 billion of such
22 assets.

23 4. Under the Enron Plan, the Transition Bonds will be owned by a grantor
24 trust rather than directly by investors.

1 5. Under the Enron Plan, payment of interest and principal on the
2 Transition Bonds appears to be monthly rather than quarterly or semi-annually.

3 6. Under the Enron Plan, PECO Energy would be required to enter into a
4 Power Purchase Agreement with Enron, which at the same time would own,
5 directly or through affiliates, the entire residual or equity interest in the
6 Transition Bonds.

7 7. Under the Enron Plan, Electric Generation Suppliers ("EGSs"),
8 including Enron, would be required to guarantee the payment of all ITC
9 applicable to energy sold by the particular EGS regardless of whether its
10 customers paid the ITC to the EGS. Thus, Enron would be in the position of
11 guaranteeing the receipt by the SPE of a portion of the ITC required by the
12 SPE to meet its obligations to pay principal and interest on the Transition
13 Bonds which in effect, are owned, directly or through affiliates, by Enron.

14 8. Under the Enron Plan, PECO Energy would be required to enter into
15 an ITC Shortfall Agreement under which a Guarantor would insure the receipt
16 by the SPE of the minimum amount of ITC projected by Enron based on a
17 level demand for electric energy in the PECO Energy service territory. Since
18 the SPE will not have sufficient cash flow to pay the fee due the Guarantor,
19 presumably either the grantor trust or Enron will pay it.

20
21 **Q. Mr. Fastow has testified on behalf of Enron that implementation of the Enron**
22 **Plan would not adversely affect PECO Energy's ability to obtain a favorable IRS**
23 **ruling on the securitization transaction. Do you agree with this conclusion?**

1 A. No, I do not agree. I do not believe that the IRS would issue a favorable ruling on
2 the Enron Plan.

3
4 **Q. Please explain why you do not believe that the IRS would issue a favorable ruling**
5 **on the Enron Plan.**

6 A. As I have already stated, there are major differences between the PECO securitization
7 plan and the Enron Plan which would prevent PECO Energy from convincing the IRS
8 that it should not treat the Enron Plan as a sale of the Intangible Transition Property
9 and related ITC to the grantor trust formed by Enron to hold the Transition Bonds.
10 In effect, there would be a straight "pay-through" of the ITC received by the SPE to
11 the Transition Bondholder and as a result the SPE would not retain a material interest
12 in the Intangible Transition Property and related ITC.

13
14 **Q. Why do you believe that the Enron Plan would be viewed by the IRS as a direct**
15 **"pay-through" of the ITC from the customers to the grantor trust formed by**
16 **Enron to hold the Transition Bonds?**

17 A. As demonstrated by the cash flows shown on Exhibit JBM-9, under the Enron Plan
18 the debt service on the Transition Bonds exceeds the ITC received by the SPE for
19 each of the first twenty-eight months after the date on which the Transition Bonds are
20 issued. Moreover, within two months after the date on which the Transition Bonds
21 are issued, the SPE's initial capitalization of \$27,305,000 (50 basis points (0.5%) of
22 the total principal amount of the Transition Bonds) will be entirely exhausted.
23 Therefore, after the second month, all of the ITC collected from the customers will be

1 paid straight through the SPE to the Transition Bondholders and the
2 overcollateralization reserve is never funded. Indeed, the computations show an
3 aggregate shortfall in payments of ITC received by the SPE of about \$450 million at
4 the end of the tenth year of the securitization transaction. As Mr. Mitchell has
5 testified, this cash flow analysis is based (1) on the statement in Sections 23(m) and
6 35(b) of the Enron Plan that the Transition Bonds will bear interest at a stated interest
7 rate of 9.66%; (2) on the same sales growth assumptions employed by Enron in its
8 financial analysis, namely that electric usage in PECO Energy's service territory will
9 remain static throughout the life of the Transition Bonds; and (3) on the ITC rates set
10 forth in the Enron Plan.

11
12 **Q. Will this straight "pay-through" structure satisfy the IRS requirements you**
13 **referred to earlier for issuing a favorable ruling?**

14 A. No, the securitization transaction proposed in the Enron Plan does not meet two and
15 possibly three of the four requirements the IRS has imposed for obtaining a favorable
16 ruling.

17
18 First, although PECO Energy will make a capital contribution to the SPE equal to at
19 least 50 basis points (0.5%) of the initial principal amount of Transition Bonds issued
20 by the SPE, this contribution will be exhausted within two months after the Transition
21 Bonds are issued. Therefore, as shown by Exhibit JBM-9, through substantially the
22 entire remaining life of the Transition Bond issue, the SPE will not have any equity at
23 risk.

1 Second, the projected ITC to be received by the SPE, including any true-ups, will not
2 be sufficient to pay principal and interest on the Transition Bonds as they become
3 due. Nor will it permit the SPE to build up the overcollateralization reserve ratably
4 over the life of the Transition Bonds in an aggregate amount equal to at least 50 basis
5 points (0.5%) of the initial principal amount of the Transition Bonds.

6
7 Third, debt service on the Transition Bonds appears to be payable on a monthly basis
8 rather than a quarterly or semi-annual basis.

9
10 **Q. Are there any other factors present in the Enron Plan that would make it more**
11 **difficult to obtain a favorable ruling from the IRS?**

12 A. Yes. First, I believe the IRS would be very concerned that the fair market value of
13 the Transition Bonds exceeds the \$5.461 billion dollar face amount that PECO Energy
14 would receive for them by approximately \$1 billion because the rate of interest
15 payable on the Transition Bonds is set at an artificially high rate as stated in Mr.
16 Hiller's testimony. Second, I believe that the IRS would be concerned because Enron
17 will own all of the Class B residual interests in the grantor trust formed to own the
18 Transition Bonds and at the same time Enron will guarantee the collectibility of the
19 ITC from all of its customers in PECO Energy's service territory and will be a major
20 customer of PECO Energy. Thus, Enron will be on both sides of the transaction.
21 These concerns would be further exacerbated if Enron also paid the Guarantor
22 designated by Enron to issue its guarantee of the receipt by the SPE of ITC at the
23 rates projected by Enron.

1 **Q. Can you quantify PECO Energy's potential income tax liability if the IRS viewed**
2 **the implementation of the Enron Plan as a taxable transaction?**

3 A. At the time the securitization transaction is effected, the entire \$5,461,000,000 of
4 Transition Bond proceeds would be subject to federal and Pennsylvania income tax at
5 a combined effective rate of 41.4%. Thus, the total federal and Pennsylvania income
6 tax liability imposed on PECO Energy in the year in which the Transition Bonds were
7 issued would total \$2,260,854,000. In other words, the net proceeds of the
8 securitization would be reduced from \$5,461,000,000 to \$3,200,146,000.

9
10 **Q. Would you please summarize your conclusions?**

11 A. In my opinion, under the Enron Plan the IRS will not give PECO Energy a favorable
12 ruling and, further, there is a real and substantial likelihood that the IRS would view
13 the implementation of the Enron Plan as a taxable transaction, thereby exposing
14 PECO Energy to a potential federal and Pennsylvania income tax liability in excess of
15 \$2.250 billion. In contrast, I am quite confident that PECO Energy will receive a
16 favorable IRS private letter ruling on its planned securitization transaction.

17
18 **V. CONCLUSION**

19
20 **Q. Does this conclude your testimony?**

21 A. Yes.

R-0092753, R-01973953, C0001;
PECO Statement No. 27-E C0007
Phila 11/19/97 et al
E. N.

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

APPLICATION OF PECO ENERGY COMPANY
FOR APPROVAL OF ITS RESTRUCTURING PLAN
UNDER SECTION 2806 OF THE PUBLIC UTILITY CODE

TESTIMONY
OF
HOWARD HILLER
REGARDING THE ENRON CHOICE PLAN

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Regarding the Petition of
Enron Energy Service Power, Inc.
for Approval of Enron's "Choice Plan"

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November 7, 1997

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2
3 **TESTIMONY OF HOWARD HILLER**

4
5 **I. QUALIFICATIONS**

6
7 **Q. Please state your name and business address.**

8 A. Howard Hiller, Seven World Trade Center, New York, NY 10048.

9
10 **Q. By whom are you employed and in what capacity?**

11 A. I am employed by Salomon Brothers Inc. ("Salomon" or "Salomon Brothers") as a
12 Vice President in the Fixed Income Capital Markets Group.

13
14 **Q. Please provide a brief description of Salomon Brothers.**

15 A. Salomon Brothers is a global investment bank that provides international financial
16 services for corporations, governments, supranational organizations, central banks and
17 other financial institutions. Salomon's principal offices are located in New York,
18 London and Tokyo.

19
20 **Q. Please describe your educational background and prior work experience.**

21 A. I graduated from Cornell University in 1974 with a B.A. in Mathematics. I received a
22 M.S. and Ph.D. in Mathematics from MIT in 1977-78. Between 1978 and 1986,
23 I held a variety of research and teaching positions at Oxford, Yale, Göttingen and
24 Columbia Universities. In 1986, I joined Citicorp Investment Bank as an Assistant
25 Vice President in the Municipal Finance Group.

1 **Q. Please outline your experience with Salomon.**

2 A. In July 1987, I joined Salomon Brothers and spent four years as a Vice President in
3 the Financial Strategy Group working with utility and industrial clients on
4 fundamental financial policy issues like capital structure, dividend policy and debt
5 management. In 1992, I moved to our Fixed Income Capital Markets Group, focusing
6 on the electric and gas industries. During the period 1993-95, I worked with Puget
7 Sound Power & Light Company on the securitization of regulatory assets
8 corresponding to prior conservation investments that led to the first legislatively
9 supported U.S. utility securitization. Salomon was the lead manager for the Puget
10 transaction.

11
12 **Q. Please describe your responsibilities in your current position at Salomon,
13 particularly as they pertain to utility securitization.**

14 A. I am broadly responsible for providing advice to Salomon Brothers' electric and gas
15 utility clients on the design and execution of capital-raising and liability-management
16 strategies pertaining to debt and preferred stock securities. Currently, a significant
17 portion of my time is committed to the application of asset-backed finance technology
18 to the restructuring of the electric utility industry. Salomon is involved with utility
19 securitization advisory assignments in a number of states, including Pennsylvania,
20 California, Michigan, Massachusetts, Connecticut and New Hampshire. Salomon
21 Brothers is currently engaged as a financial advisor to PECO Energy in its
22 securitization program.

1 **Q. Have you testified on other occasions before utility regulatory agencies?**

2 In January 1997, I submitted testimony in PECO Energy's Application for Issuance of
3 a Qualified Rate Order under Sections 2808 and 2812 of the Competition Act (Docket
4 R-00973877).

5
6 **II. PURPOSE OF TESTIMONY**

7
8 **Q. Please describe the scope and purpose of your testimony.**

9 A. I have been asked by PECO Energy Company ("PECO Energy" or the "Company")
10 to evaluate the securitization of stranded costs under the Choice Plan (the "Enron
11 Plan") submitted by Enron Energy Services Power, Inc. ("Enron"). Specifically, I
12 have been asked to evaluate the feasibility of the securitization proposal under the
13 Enron Plan with respect to certain features of that proposal and the effects of Enron's
14 securitization plan on PECO Energy and Pennsylvania electric customers.

15
16 **Q. Can you summarize your broad conclusions?**

17 A. Yes. Without a release of the PECO Mortgage, the securitization is not possible.
18 Without a favorable tax ruling, PECO Energy's securitization is rendered
19 uneconomic.

20
21 Further, in applying securitization to stranded cost recovery, it is possible to have
22 "too much of a good thing." While securitization in moderation can be beneficial for

1 all parties involved, in excess, it will significantly weaken the utility's financial
2 integrity and, as a consequence, its ability to provide safe and reliable service. The
3 Pennsylvania legislature recognized this fact by authorizing the Public Utility
4 Commission (the "Commission") to issue a Qualified Rate Order only for amounts the
5 Commission finds to be "in the public interest" and then granting the utility discretion
6 as to whether or not to issue Transition Bonds authorized by the Commission in a
7 Qualified Rate Order. By maximizing the amount of securitization, while leaving the
8 costs associated with securitization with PECO Energy, Enron achieves its goal of
9 raising \$5.461 billion to pay PECO Energy for its stranded costs, but significantly
10 damages PECO Energy's financial integrity in the process.

11
12 **III. FEASIBILITY OF THE ENRON SECURITIZATION**
13 **PROPOSAL FROM A TAX AND LEGAL PERSPECTIVE**
14

15 **Q. Mr. Mitchell, in his testimony, discussed the feasibility of the Enron Plan and the**
16 **inability under the Enron Plan to obtain a release of the Intangible Transition**
17 **Property from the lien of PECO Energy's mortgage (the "PECO Mortgage").**
18 **How does the structure of the Enron Plan cause this result?**

19 **A.** As Mr. Fastow mentions in his testimony, the mechanics of the securitization
20 proposals under both the Partial Settlement and the Enron Plan are fundamentally the
21 same (the so-called "preferred" structure that Mr. Fastow references from
22 Mr. Mitchell's original testimony). Enron goes one step further and "splits" the

1 Transition Bonds into two classes: the Class A Pass-Through Certificates that will
2 effectively be market-based bonds, priced near par and sold to investors, and the
3 Class B Pass-Through Certificates that will be the residual interest that Enron takes.
4 To the extent that the Class B Certificates have value, the trustee under the PECO
5 Mortgage will view the transfer of Intangible Transition Property as inconsistent with
6 the asset release provisions of the PECO Mortgage.

7
8 **Q. Explain how the asset release provisions of the PECO Mortgage would prevent**
9 **the transfer of the Intangible Transition Property.**

10 A. After "splitting" the Transition Bonds, Enron plans to market \$5.461 billion in Class
11 A Certificates to investors and to transfer the proceeds from the sale as payment for
12 the Intangible Transition Property. The Class B Certificates will be issued directly to
13 Enron; however, under the Enron Plan, Enron will not be "paying" or "transferring
14 value" for the Class B Certificates. Because the Class B Certificates have positive
15 "value," the total amount actually being transferred in exchange for the Intangible
16 Transition Property (the payment for the Class A Certificates) is less than the value of
17 the Class A Certificates and Class B Certificates combined. As discussed by Mr.
18 Mitchell, the trustee under the PECO Mortgage is required to receive fair and equal
19 value prior to releasing the Intangible Transition Property and Intangible Transition
20 Charges from the lien of the PECO Mortgage. Because the Mortgage Trustee will
21 not be receiving fair and equal value for the Intangible Transition Property, the

1 Company will not permit the Intangible Transition Property to be released from the
2 lien of the PECO Mortgage.

3
4 **Q. What is the consequence of PECO Energy not having the Intangible Transition
5 Property released from the lien of the PECO Mortgage?**

6 A. The release of the Intangible Transition Property from the lien of the PECO Mortgage
7 is essential for the issuance of Transition Bonds.

8
9 **Q. The inability of PECO Energy to release the Intangible Transition Property
10 hinges on the value of the Class B Certificates. Have you estimated the value of
11 Enron's Class B Certificates?**

12 A. Yes. We estimate that the value of the Class B Certificates under current market
13 conditions (a 10-year Treasury rate of 5.90%) is approximately \$1.015 billion. If
14 Treasury rates rise to 7%, the upper end of Enron's 5.75%-7% range, then the value
15 of the Class B Certificates would decline to \$638 million.

16
17 **Q. Please describe how the cash flows of the Class B Certificates are determined.**

18 A. The cash flows of the Class B Certificates are effectively the residual flows that
19 remain after the Class A Certificates are serviced. In order to calculate the interest
20 and principal payments on the Class A Certificates, we have to assume a coupon rate
21 and a monthly retirement schedule for the principal amount of \$5.461 billion. An
22 appropriate market rate for the Class A Certificates is currently about 6.5%. There is

1 some flexibility with regard to the principal retirement schedule and we have created
2 one that is consistent with a weighted average life of 7.1 years. By assembling this
3 data, we can calculate the residual cash that flows to the holders of the Class B
4 Certificates.

5
6 **Q. How did you determine a market rate of 6.5% on the Class A Certificates?**

7 A. The likely pricing for bonds backed by regulatory assets has been a topic of thorough
8 discussion by investors, credit analysts, asset-backed specialists and electric utilities.
9 The consensus that has emerged is that bonds backed by transition charges will likely
10 be priced near where credit card securities with similar average lives are priced
11 (adjusted for the so-called amortization penalty). Given that the current reference
12 Treasury yield is about 5.9%, an appropriate market rate would be about 6.5%.

13
14 **Q. What are the sensitivities of this calculation to an increase in the reference
15 Treasury rate to 7%, the upper end of Enron's range?**

16 A. If Treasury rates increase to 7%, we assume that the appropriate market rate on the
17 Class A Certificates rises by a corresponding amount to 7.6%. In this case, the total
18 cash payment to the Class B Certificates is \$999 million with a present value of \$638
19 million, assuming a discount rate equal to the market rate on the Class A Certificates
20 of 7.6%. If the discount rate is increased to 8.5%, the present value of the Class B
21 Certificate payments declines to \$606 million.

1 **Q. Mr. Mitchell and Mr. Sharpe also discussed the difficulty of obtaining a**
2 **favorable tax ruling from the Internal Revenue Service ("IRS") on the**
3 **securitization proposal in the Enron Plan because of the inadequacy of the**
4 **Intangible Transition Charge ("ITC") revenue stream and the "pass-through"**
5 **nature of the structure suggested by the Enron Plan and the testimony submitted**
6 **in support thereof. Describe the inadequacy of the ITC revenue stream proposed**
7 **by Enron.**

8 A. If Enron's intent is to have Transition Bonds issued in the principal amount of \$5.461
9 billion at a "stated interest rate" of 9.66% as described in the Enron proposal and the
10 testimony submitted in support thereof (see Enron proposal p.22 and testimony of
11 Andrew Fastow, p.17-18), then the ITC cash flow in the early years is insufficient to
12 cover the payment of interest to Transition Bondholders.

13
14 **Q: What does "stated interest rate" mean?**

15 A: The generally accepted definition of "stated interest rate" is the coupon rate of a
16 bond.

17
18 **Q: How does the interest rate affect the analysis for the tax ruling?**

19 A: If the coupon rate is 9.66%, then during substantially all of the time the Transition
20 Bonds are outstanding, the cash flow is insufficient to pay interest on the Transition
21 Bonds, the capital required by the IRS is used up in two months, according to the
22 calculations included as Exhibit JBM-9 to Mr. Mitchell's testimony, and the cash flow

1 becomes a straight "pass-through" of ITC payments to Transition Bondholders. Given
2 these circumstances, it is unlikely that the structure would obtain a favorable tax
3 ruling from the IRS.
4

5 **IV. ADVERSE IMPACT OF SECURITIZING \$5.461 BILLION OF**
6 **STRANDED COSTS ON PECO ENERGY'S FINANCIAL INTEGRITY**
7

8 **Q. Please describe the difference between the Enron and PECO Energy**
9 **securitization proposals.**

10 A. The "macro" difference between the PECO Energy and Enron securitization structures
11 is the amount of stranded costs that is securitized. Under the Partial Settlement, the
12 Commission is to authorize PECO Energy to securitize up to \$4 billion of the \$5.461
13 billion of stranded costs that PECO Energy is authorized to recover. The Enron Plan,
14 to be implemented at all, requires that all \$5.461 billion of stranded costs be
15 securitized. As Mr. Mitchell discusses in his testimony, the Enron Plan is totally
16 dependent on a successful securitization.
17

18 **Q. Are there reasons why PECO Energy might choose not to securitize all of its**
19 **stranded costs even if it were authorized to do so?**

20 A. Yes. There are a number of important reasons why PECO would choose not to
21 securitize the full \$5.461 billion. These reasons include (i) the significant reduction
22 in cash flow resulting from securitization and (ii) the rating agencies' warning that

1 "over-securitization" may weaken the credit strength of both the Transition Bonds and
2 PECO Energy's own indebtedness.

3
4 **Q. What is the impact on PECO Energy's cash flow of increasing the amount of
5 stranded costs to be securitized to the amount proposed in the Enron Plan?**

6 A. Securitization is a double-edged sword for utilities. On the one hand, resolving the
7 uncertainty of stranded cost recovery generally sends a positive signal to the equity
8 market. On the other hand, securitization exacts a price: the utility's interest
9 coverage ratios and other key financial criteria are significantly impaired, likely
10 leading to sharply lower bond ratings, as detailed in Mr. Mitchell's testimony.
11 Furthermore, the reduction in the utility's cash flow is directly proportional to the
12 amount of securitization.

13
14 **Q. What other adverse financial impacts do you believe would occur from
15 securitizing \$5.461 billion of stranded costs?**

16 A. Securitizing \$5.461 billion of stranded costs would also influence the rating agencies'
17 view of PECO Energy's financial integrity and, therefore, impact the Company's
18 credit strength. The rating agencies have been candid about their view that there are
19 limits on the value of securitization to a utility. Although securitization is viewed
20 broadly as supportive of credit quality, securitizing *too many* assets can denigrate the
21 credit quality of the utility's debt.

1 Moody's wrote in their February 28, 1997 report: ". . . investors should be mindful
2 of the fact that although the pool of company bondholders will shrink, the
3 introduction of securitized bondholders entitled to the same cash flow to which current
4 bondholders are entitled may compromise current bondholders' position."

5
6 **Q. Does the Competition Act recognize that securitizing stranded costs may be
7 detrimental to the utility and not in the public interest?**

8 **A.** Yes. The Competition Act grants the utility the discretion of whether or not to issue
9 all or any amount of Transition Bonds authorized in a Qualified Rate Order. The
10 Pennsylvania legislature recognized that there may be circumstances where
11 securitizing stranded costs may be detrimental to the utility. The Competition Act
12 specifically states that following the issuance of a Qualified Rate Order the electric
13 utility "retains sole discretion regarding whether to assign, sell, or otherwise transfer
14 Intangible Transition Property or to cause the transition bonds to be issued, including,
15 but not limited to, the right to defer or postpone such assignment sale, transfer or
16 issuance."

17
18 In addition, the Competition Act authorizes the Commission to grant the utilities
19 permission to issue Transition Bonds only in an amount the Commission determines to
20 be in the "public interest." As discussed above and in the testimony of Mr. Mitchell,
21 securitizing \$5.461 billion in stranded costs will have a devastating effect on PECO

1 Energy's financial integrity and will adversely affect PECO Energy's ability to
2 provide safe and reliable service to its customers.

3
4 **V. GENERAL COMMENTS AND CONCERNS**

5
6 **Q. Assuming the viability of Enron's securitization proposal, do you have any**
7 **comments on Enron's up-front rate reduction of 20%?**

8 A. Enron's rate proposal should be evaluated in terms of its overall economic impact,
9 including its impact on PECO Energy's financial integrity and its ability to continue
10 to provide safe and reliable service at current levels, as PECO Energy is required to
11 do under the Enron Plan. My main concern with the Enron Plan is that it leaves the
12 impression that the securitization technology, if appropriately applied, can magically
13 create 20% rate reductions. The Commission in deciding the amount of securitization
14 that is "in the public interest" should question what the actual source of these savings
15 is and whether Enron is making a meaningful economic contribution to this process in
16 exchange for becoming the provider of last resort to a significant portion of
17 Pennsylvania's electric consumers.

1 **Q. Assuming again the viability of Enron's financing proposal, how does the Enron**
2 **Plan achieve a 20% rate reduction in the first two years?**

3 A. Ignoring some of the complexities of the Enron Plan structure, Enron's proposal
4 increases the amount of savings available to customers by (i) increasing the amount of
5 securitization (from up to \$4 billion to \$5.461 billion), and (ii) shifting savings from
6 the late years to the early years. As Mr. Mitchell discusses, increasing the
7 securitization amount will substantially damage PECO Energy's financial integrity and
8 its ability to provide safe and reliable service.

9
10 **Q. Do you have any other concerns with the Enron securitization proposal?**

11 A. Yes, I would like to mention two issues that are not addressed in the Enron Plan.
12 First, the proposal does not appear to take into account the potential impact of
13 Pennsylvania's Gross Receipts Tax in calculation of revenues. Second, the Transition
14 Bond structure of 124 months violates the Competition Act's limitation on the
15 maturity of Transition Bonds to 10 years, or 120 months.

16
17 **Q. Please restate your broad conclusions.**

18 A. Enron has devised a plan that substantially weakens PECO Energy at a time of
19 significant change within the electric utility industry. Despite industry restructuring,
20 PECO Energy remains responsible for the maintenance of the transmission and
21 distribution system, the billing and collection process and, even under the Enron Plan,
22 the generation of electricity for default customers. The Enron Plan is a complex

1 financial scheme that re-engineers PECO Energy effectively into an "employee" of
2 Enron, where PECO Energy contractually provides to Enron all of its traditional
3 utility functions. Further, the Enron Plan falls apart without securitization; the Partial
4 Settlement does not. In addition, as the testimony of Mr. Sharpe and Mr. Rayzis
5 clearly indicate, there remain a number of unresolved technical and legal obstacles
6 that the Enron Plan has failed to address in any substantive detail. My testimony is,
7 in essence, that "there is no free lunch" and the excessive securitization that Enron
8 proposes will do irreparable damage to PECO Energy's financial integrity,
9 particularly in light of PECO Energy's continuing critical role in all facets of serving
10 electric customers in Pennsylvania.

11
12 **Q. Does this conclude your testimony?**

13 **A. Yes, it does.**

R-00713953, R-009739530001
PECO Statement No. 28-E
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Phila 11/19/97
C.H.

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

APPLICATION OF PECO ENERGY COMPANY
FOR APPROVAL OF ITS RESTRUCTURING PLAN
UNDER SECTION 2806 OF THE PUBLIC UTILITY CODE

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TESTIMONY
OF
GEORGE RAYZIS
REGARDING THE ENRON CHOICE PLAN

DOCUMENT
FOLDER

Regarding the Petition of
Enron Energy Service Power, Inc.
for Approval of Enron's "Choice Plan"

DOCKETED
NOV 21 1997

November 7, 1997

TESTIMONY OF GEORGE RAYZIS

1 **Q. Please state your name and business address.**

2 A. George Rayzis, 123 South Broad Street, Philadelphia, PA 19103.

3

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

5 A. I am employed by First Union National Bank ("First Union") as a Vice President in
6 its Corporate Trust Department.

7

8 **Q. Please state your professional background and your current responsibilities with**
9 **First Union.**

10 A. In my present position in the Corporate Trust Department, I am responsible for the
11 administration of corporate and municipal bonds in accordance with the governing
12 bond documents. My duties also include the administration of escrow accounts in
13 accordance with the governing escrow agreement.

14

15 First Union is the trustee for the mortgage indenture securing the First and Refunding
16 Mortgage Bonds issued by PECO Energy (the "PECO Mortgage"). I have direct
17 responsibility for administration of the PECO Energy Mortgage Bond account at First
18 Union.

1 I have fourteen years of experience working in the corporate trust industry and three
2 years of experience working as a bank internal auditor. I received a BS from LaSalle
3 College and a MBA from Temple University.

4
5 **Q. As trustee, whose interests do you represent?**

6 A. Under a mortgage indenture, the lien on the mortgaged property is granted by the
7 debtor to the mortgage trustee for the benefit of the bondholders. In such capacity,
8 the mortgage trustee acts as a fiduciary for the bondholders.

9
10 **Q: What is the principal amount of PECO Energy's first mortgage bonds that
11 remain outstanding?**

12 A: As of September 30, 1997, \$3,844,355,000 of first mortgage bonds that were issued
13 under the PECO Mortgage remained outstanding.

14
15 **Q: What property of the Company is subject to the lien of the PECO Mortgage?**

16 A: Substantially all of the properties of the Company are subject to the lien of the PECO
17 Mortgage. The Company's property that is subject to the lien of the PECO Mortgage
18 includes all of the Company's "rights, claims, contracts, leases, patents, patent rights
19 and agreements, all accounts receivable, accounts, claims, demands, choses in action,
20 books of account, cash assets, franchises, ordinances, rights, powers, easements,
21 water rights, riparian rights, licenses, privileges, immunities, concessions and
22 consents now or hereafter owned by the Company [and] all other property, real,

1 personal and mixed not hereinbefore specified or referred to, of every kind and nature
2 whatsoever now owned, or which may hereafter be owned by the Company (except
3 shares of stock, bonds or other securities not now or hereafter specifically pledged
4 hereunder as aforesaid)" (Page 12 of the PECO Mortgage).

5
6 **Q: Do the terms of the PECO Mortgage permit the Company to sell property free**
7 **from the lien of the PECO Mortgage?**

8 A: Article VI, Section 3 of the PECO Mortgage provides that, so long as the Company is
9 not in default, mortgaged property may be released from the lien of the PECO
10 Mortgage provided the Company has sold or exchanged such property to be released
11 for cash or other property of at least equal value. Article VI, Section 4 of the PECO
12 Mortgage requires that the cash or other property received by PECO Energy from the
13 sale of mortgaged property must be deposited with the mortgage trustee.

14
15 **Q: How will the trustee know that property to be released from the PECO Mortgage**
16 **has been sold for cash or other property of at least equal value?**

17 A: Article VI, Section 6 of the PECO Mortgage requires the trustee to receive a sworn
18 statement of the president or a vice president of PECO Energy, and a copy of a
19 resolution of PECO Energy's board of directors, stating, among other things, that the
20 sum of the cash and/or the value of the other property received by PECO Energy
21 equals or exceeds the fair and reasonable value of the property to be released from the
22 lien of the PECO Mortgage. That section further provides that if the fair value of the

1 property to be released from the lien of the PECO Mortgage is 10% or more of the
2 aggregate principal amount of bonds secured by the PECO Mortgage at the time, the
3 trustee must be supplied with a certificate or opinion by an independent engineer,
4 appraiser or other expert as to the fair value of the property to be released and that
5 the proposed release will not impair the security under the PECO Mortgage in
6 contravention of the provisions of the PECO Mortgage.

7
8 **Q. Mr. Mitchell testified that the PECO Mortgage will constitute a first lien on the**
9 **Intangible Transition Property while it is held by the Company. Do you agree**
10 **with this conclusion?**

11 A. Yes, I have been so advised by my counsel.

12
13 **Q: Would the PECO Mortgage require the certificate of an independent engineer,**
14 **appraiser or expert, as described above, in connection with the sale of the**
15 **Intangible Transition Property and related Intangible Transition Charges to the**
16 **special purpose entity in return for cash as part of the process of securitization?**

17 A: Yes, because the value of the Intangible Transition Property and related Intangible
18 Transition Charges would exceed \$384 million, or 10% of the mortgage bonds
19 outstanding, the PECO Mortgage would require such a certificate.

1 **Q. Does the PECO Mortgage permit the mortgage trustee to accept a sworn**
2 **statement and the opinion of the independent appraiser or experts from any**
3 **party other than PECO Energy?**

4 A. No. Article VI, Section 3 of the PECO Mortgage is very specific. The request for
5 the mortgage release must be from the Company and must be accompanied by the
6 sworn statement of the Company and the independent engineer, appraiser or expert as
7 to the fair value of the property to be released.

8
9 **Q. Based on Mr. Mitchell's testimony that the Company would not be able to deliver**
10 **the sworn statement of the Company or opinion of the independent appraiser or**
11 **expert that the amount received by PECO Energy under the Enron Plan equals**
12 **the fair value of the Intangible Transition Property, would the Company be**
13 **permitted under the terms of the PECO Mortgage to allow the release of the**
14 **Intangible Transition Property?**

15 A. Absolutely not. Article V, Section 7 of the PECO Mortgage provides that "[the]
16 Company will not voluntarily create or suffer to be created any... lien... having
17 priority to the lien of [the] indenture...." Article VIII, Section 2 declares the breach
18 of such a covenant to be an "event of default" under the PECO Mortgage.

19
20 **Q. Does this conclude your testimony?**

21 A. Yes, it does.