

Debt, Equity, and Dividend Restrictions

ERRA Tariff and Pricing Committee

Budapest, Hungary

June 11, 2013



Examples to be Described

- Poor Management Decisions
- Ring Fencing
- Relaxed Regulation

Poor Management Decisions

- The Company

- Small regulated (water) utility is privately held
- Owner is also the president of the utility
- Regulator previously determined that \$20,000 return was an appropriate return for the capital investment
- Owner took the entire \$20,000 return as a dividend to himself -- this is in addition to a salary
- \$20,000 dividend distribution creates a negative retained earnings
- Owner claims he used the dividends to pay expenses such as maintenance
 - He was previously ordered to establish a reserve account for repairs



Poor Management Decisions

- Consumer Advocate View



- Dividends should be treated as a loan – needs to be repaid
- When distributed dividends exceed the net income, owner should be required to pay interest on the difference
 - Interest should be at utility's weighted average cost of debt
- Set the allowed (not guaranteed) return based on an operating ratio
 - $\text{Net Income} / \text{Revenues} = 8.9\% = \$15,236$
- Not the first time this has happened
 - Distribution of dividends had occurred in past regardless of earned net income

Poor Management Decisions

- Regulator's Decision

- Utility is not entitled to a guaranteed return or a guaranteed \$20,000 dividend
- Agreed that when dividends in excess of net income are distributed, this is really a loan to the shareholder
- Loan should be paid back with interest based on weighted average cost of debt

Ring Fencing

- What is it?
 - Methods used to separate the financial value of a utility from its parent or affiliate in order to protect it from unnecessary financial risk or instability
 - A shell is built around the utility
- What types of methods are used?
 - Financial restrictions
 - Structural separations
 - Regulatory restrictions on cash and asset transfers



Ring Fencing

- Regulatory restrictions
 - Prohibit the use of utility debt for non-utility purposes
 - Prohibit a utility from lending money to or guaranteeing any obligations of its parent or non-regulated affiliates
 - Limit non-utility investments held by a public utility
 - No securities issuances without regulatory approval
 - Authorize a regulator to order a utility to cease paying dividends on common stock when there is a finding of capital impairment

Ring Fencing

- Regulatory restrictions
 - Restrict dividend payments to a parent in order to maintain financial viability of the utility
 - Direct the utility to maintain a minimum common equity portion of its capital structure
 - Regulatory approval for significant ownership changes
 - Debt must follow the asset if it is moved to another corporate entity
 - Minimum debt/cash flow ratio
 - Separate books and records for the utility from other corporate operations

Relaxed Regulation



- **Wyoming Statute 37-6-103**
 - (a) No regulatory approval is required for the issuance of securities if the term is 18 months or less
 - (b) The regulator may exempt securities from the need for approval, if it finds that approval is not required in order to satisfy the public interest.

Relaxed Regulation

- **Rocky Mountain Power (Wyoming)**
 - Wanted exemption so it would not have to seek permission each time it issued securities
 - Uninterrupted access to securities market
 - Ratepayers benefit when there is timely access to capital markets
 - Cost of preparing each application may be \$10,000 to \$25,000 – many applications might be necessary
 - Did not ask for Commission to relinquish authority
 - Quarterly report will be filed with the details of securities issuances
 - Commission will still review financing costs in rate cases
 - Established certain limitations on specific transactions

Relaxed Regulation

- Quarterly Report

- List of Long Term Debt

- Principal, Issuance Date, Maturity Date, Interest Rate, Value Net of Unamortized Discount or Premium

- Preferred Stock

- Shares Outstanding, Stated Value, Value net of Issuance Expense, Dividend Rate

- Revolving Credit Lines > 18 Months at Inception

- Amount Available for Borrowing, Amount Borrowed

Relaxed Regulation

- Quarterly Report

- Common Equity and Equity Contributions
 - Value of Shares Outstanding, Additional Paid-in Capital, Retained Earnings, Capital Contributions from Parent Company,
- Showing that Outstanding Securities do not Exceed Fair Value of Properties (Statutory Requirement)
- Statement of Use of Securities Issuances (Statutory Requirement)
- Capital Structure

Relaxed Regulation

- Agreed Upon Restrictions

- No dividends (without approval) that will reduce equity portion of capital structure below 44%
- No dividends (without approval) that will reduce the common equity portion of *Total Adjusted Capital* below 35%
 - *Total Adjusted Capital* = common equity, preferred equity, long-term debt, short-term debt, and capitalized lease obligations
- No loans or transfer of funds (other than allowed dividend) will be made to its parent corporation
- Utility will not become guarantor of any obligation or liability of its parent corporation
- The parent will not pledge any of the assets of the utility as backing for any securities of the parent corporation

Contact Information

Denise Parrish

Deputy Administrator

Office of Consumer Advocate

Wyoming Public Service Commission

Cheyenne, Wyoming USA

Denise.Parrish@wyo.gov