Calculation of Stranded Costs and its Effect on Pricing

- Stranded costs = book value of asset minus market value of asset.
- Where the market value is less than the book value, the asset is considered to be stranded.

An Example –

- A privately owned utility invests $4.0 billion in a nuclear power plant assuming ratepayers will pay $.06 per kWh under rate base/rate of return regulation.
- In a competitive market, ratepayers will only pay $.04 per kWh.
- Therefore, the nuclear plant may now be worth $2.5 billion.
- The difference between $4.0 and $2.5 billion is considered to be a stranded cost, and would ordinarily be charged to ratepayers.

Method of Recovery of Stranded Costs

- Recover the entire investment and a full rate of return on the investment through rates.
- Securitization.

Rate-Base/Rate-of-Return Ratemaking

- A customer's rates are currently established using the company's weighted average cost of capital (i.E., A mix of debt at embedded rates of interest, equity at an allowed rate of return and preferred stock at an embedded dividend rate). This is rate-base/rate-of-return ratemaking.

Securitization

- Asset securitization replaces the traditional utility revenue requirement with an annuity-type revenue requirement, which has a cost of capital at a 100% debt rate.
- In addition, the securitization is structured to achieve an AAA bond rating on the securitization debt.
- It is the substitution of a 100% AAA-rated debt annuity revenue requirement for the utility's weighted average cost of capital which gives rise to customer savings.

Securitization (continued)

- The securitization of bondable stranded costs is made possible by statute which provides that the bond's principal and interest will be collected through the imposition of a non-bypassable tariff collectible from the company's customers.
- The recovery of bondable stranded costs is an irrevocable statutory right. In addition, the statute awards true sale status to the transfer of the bondable property to a finance subsidiary, supporting the legal conclusion that the transfer constitutes a true sale for bankruptcy purposes.
- The rating agencies, due to the favorable financing and legal structure contained in the statute, do not view securitization as company debt. Therefore, a company's borrowing ability is not reduced as result of securitization.

Method of Sale

- Negotiation
- Competitive sale

Use of Proceeds

- Reduce debt
- Reduce equity

Administrative Securitization Applicability to Bulgaria