

**COMMONWEALTH OF PUERTO RICO
PUERTO RICO ENERGY COMMISSION**

IN RE:

PUERTO RICO ELECTRIC POWER
AUTHORITY REVITALIZATION
CORPORATION,

Petitioner.

NO. CEPR-AP-2016-0001

**SUBJECT: TESTIMONY
SUPPORTING PETITION FOR
RESTRUCTURING ORDER**

Rebuttal Testimony of

MICHAEL MACE

Managing Director,

Public Financial Management, Inc.

On behalf of the

Puerto Rico Electric Power Authority Revitalization Corporation

May 16, 2016

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1 **I. INTRODUCTION AND SUMMARY**

2 **A. Witness Identification**

3 Q. **Please state your name.**

4 A. My name is Michael Mace.

5 Q. **Have you previously submitted testimony to the Commission in this Docket?**

6 A. Yes. I submitted written direct testimony, identified as Puerto Rico Electric Power
7 Authority Revitalization Corporation (“Corporation”)¹ Ex. 4.00, along with attachments
8 thereto.

9 Q. **Have there been any material changes in your background, qualifications, or duties
10 since you submitted your direct testimony?**

11 A. No, there has not.

12 **B. Summary of Testimony and Attachments**

13 Q. **What subjects does your rebuttal testimony address?**

14 A. I testify concerning issues relating to the bond markets, the size and characteristics of the
15 proposed transaction, and the portion of the PREPA legacy debt that the Bonds to be
16 issued by the Corporation will defease. I also reconfirm that the projected professional
17 fees and costs associated with a transaction of this magnitude and complexity are
18 reasonable and customary, and that the services provided are essential to the transaction
19 and to ultimately delivering benefits that far exceed those costs.

¹ Where I use capitalized terms that are defined in the Petition or the Revitalization Act, I intend the same meaning.

20 **II. RESPONSE TO THE TESTIMONY FOR THE PUERTO RICO ECONOMIC**
21 **COMPETITIVENESS AND SUSTAINABILITY INSTITUTE**

22 **Q. Attorney Agrait, testifying for the Puerto Rico Economic Competitiveness and**
23 **Sustainability Institute (“ICSEPR”), opines that approval of the proposed Bond**
24 **issuance should be delayed until the securities market environment is conducive for**
25 **PREPA to issue new bonds. Is this a sound recommendation that the Commission**
26 **should heed?**

27 **A.** No. First off, there may be some confusion concerning the Corporation and PREPA and
28 their respective roles. The Bonds to be issued under the authority of the proposed
29 Restructuring Resolution are issued by the Corporation, not by PREPA. The Corporation
30 and PREPA are separate entities with entirely separate balance sheets and credit. The
31 credit quality of PREPA and whether the securities market is conducive to PREPA
32 issuing new bonds are distinct from the credit quality of the Corporation and its ability to
33 issue securitized debt. Indeed, one of the main benefits of securitization is that, by
34 having a completely new and separate issuer, it mitigates the difficulties and costs that
35 would be associated with PREPA trying to issue debt.

36 Second, it is certainly true that there is fluidity and uncertainty in the market for a
37 variety of Puerto Rico debt instruments. However, a restructuring of various
38 Commonwealth and public corporation borrowers is an essential component of any plan
39 to stabilize the Puerto Rican economic environment and financial markets view of Puerto
40 Rican public debt. The issuance of the Bonds is a critical and necessary part of the plan
41 to restructure and stabilize PREPA’s debt burden. Waiting to approve the issuance of the
42 Corporation’s Bonds until PREPA is able to issue its own debt on reasonable terms is not

43 logical and would not accomplish a timely restructuring of PREPA's debt. PREPA
44 cannot afford to wait any longer, as the costs of such would adversely affect all
45 stakeholders involved, including PREPA's customers. The Commission should act now.

46 **Q. Mr. Kuhn, also testifying for ICSEPR, claims that the proposed transaction is**
47 **outside the norm, that other utility securitizations in the United State have been for**
48 **smaller amounts and involved utilities in better financial health than is PREPA.**
49 **Does Mr. Kuhn's observation raise any concern?**

50 **A.** While the total amount of securitized debt proposed will be larger than any prior single
51 issuance of utility securitization debt, there have been several multi-billion dollar utility
52 debt securitization transactions sold in the public markets, and this issuance is not so
53 large as to raise doubts based on its size.

54 It is also important to keep in mind the difference between: (1) the total amount of
55 securitization debt that will be issued, and (2) the far smaller amount of securitization
56 debt that is anticipated to be sold to the public as a part of the overall restructuring in
57 order to raise new money from the markets. All the Bonds described above that defease
58 or retire existing PREPA debt do not impose, and will not be seen by the market as
59 imposing, new net costs or new net debt on PREPA and its customers. The vast majority
60 of the securitization debt will either be exchanged for existing PREPA bonds, or be
61 issued as Mirror Bonds to a Trustee that will hold the Mirror Bonds and apply the debt
62 service payments from the Mirror Bonds to make debt service payments on insured
63 PREPA Bonds that will remain outstanding. The RSA creditors that are parties to these
64 transactions have already accepted the terms of these securitization components through

65 the RSA process. It is also possible that additional creditors may choose to exchange
66 their legacy PREPA debt for Bonds, and while such additional exchanges will be
67 incrementally better for PREPA, they are not essential. The value of the Bonds that will
68 actually be sold to the public to raise new money is relatively small in comparison to
69 most utility securitization transactions. Only approximately \$180 million of New Money
70 Bonds are expected to be sold to the public.

71 Thus, while the overall amount of securitized debt may appear large in relation to
72 other securitization offerings, the vast majority of the debt will be exchanged for existing
73 PREPA debt under a set of conditions that have already been agreed to with the RSA
74 creditors that will be accepting the securitization as a condition to the concessions they
75 are willing to make for the exchange.

76 Finally, I note that in every issuance of utility debt securitization the credit rating
77 of the securitization debt was higher than that of the utility that benefited from the
78 issuance. There have been cases where the related utility was rated below investment
79 grade, and the utility securitization debt was rated AAA.

80 **Q. In any event, would Mr. Kuhn's claims be a reason to reject the transaction?**

81 A. No. There is no evidence that the size of the transaction will be a barrier to its success
82 and, as I described, the vast majority of the entities who will acquire Bonds are already
83 parties to the consensual RSA. The fact that the total value of the Bonds could be \$7
84 billion or more is, if anything, indicative of the size of the hurdle PREPA faces absent the
85 transaction, not a reason to reject it.

86 Q. **Mr. Kuhn recommends that the Commission order the preparation, submission,**
87 **and review of a “reasonably constructed demand forecast study”. He postulates**
88 **that such a study would show the weakening electricity demand, which would give**
89 **potential investors pause. Putting aside his claims and assumptions about the**
90 **demand forecast itself, would such a study reveal information affecting the ability of**
91 **the Transition Charges to repay the Bonds and other Approved Financing Costs?**

92 A. No. A particular demand forecast, or assumption about future demand, is not the basis of
93 the workability of the proposed transaction. The securitization legal structure serves as
94 the protection for investors against potential reductions in demand, among other things.
95 The Transition Charge Adjustment Mechanism is designed to mathematically respond to
96 changes in demand and ensure the Bonds are paid. Such mechanisms exist in virtually
97 every securitization, and are recognized and accepted by the market.

98 Indeed, uncertainty over the future is one of the many reasons that securitization
99 is perceived to be perhaps the only possible way to gain investor support for any form of
100 PREPA debt restructuring. By agreeing to the exchange, existing creditors who will
101 receive securitization bonds in exchange for the economic concessions they make as part
102 of the exchange for their existing PREPA bonds have essentially demonstrated their
103 expectation that securitization is the best possible means of protecting them against future
104 reductions in demand for electricity.

105 Q. **Mr. Kuhn also testifies that the securitization only covers 70% of PREPA’s total**
106 **debt and claims that there is uncertainty with how the remaining debt will affect**
107 **consumers. Is this a valid concern about the transaction?**

108 A. No, it is not. The successful restructuring of the planned 70% of existing PREPA debt –
109 debt that represents the holdings of the creditor group that have participated in the
110 restructuring negotiations and RSA – will produce substantial present value and cash
111 flow savings – savings that are critical to PREPA’s ability to transform itself to a modern,
112 financially viable utility that will benefit its customers and the whole of Puerto Rico. A
113 restructuring of that PREPA debt under those anticipated terms would be a success.
114 Indeed, restructuring on those anticipated terms is expected to produce net present value
115 savings exceeding \$750 million.

116 Mr. Kuhn also ignores that many of the other creditors not included in the 70%
117 can also join in exchanging their debt for Bonds on the same terms as the 70% that are
118 currently required as a condition to the execution of the restructuring plan, and there is no
119 *a priori* reason to assume that they will not. These remaining creditors have not declared
120 that they will not accept the terms agreed to by the majority of the existing PREPA
121 creditors; they simply have not participated in the restructuring negotiations. Many of
122 these creditors are too small to have been included in negotiations as a practical matter.
123 Should they also join, the restructuring will be even more successful. But, if the
124 remaining 30% of PREPA’s debt does not participate in the transaction, it will simply
125 remain unchanged. It does not become more threatening or more expensive as a result of
126 the successful restructuring of other debt.

127 The bottom line remains: the restructuring as proposed, with 70% participation,
128 would be a success as described in the direct testimonies of the witnesses for the
129 Corporation.

130 **III. RESPONSE TO THE STATEMENT OF THE INDEPENDENT CONSUMER**
131 **PROTECTION OFFICE**

132 **Q. The statement submitted by the Oficina Independiente de Protección al Consumidor**
133 **(“OIPC” or the “Independent Consumer Protection Office”) claims that the**
134 **estimated amounts of Upfront Financing Costs and Ongoing Financing Costs are**
135 **related to professional fees and are alarming. Are those claims accurate?**

136 **A.** No. First, I must note that OIPC is incorrect that the Upfront Financing Costs and
137 Ongoing Financing Costs, or even a majority of them, represent professional fees. For
138 example, the largest single item, accounting for about 2/3 of the estimated Upfront
139 Financing Costs, is a reserve account deposit, not a fee of any kind. *See* Attachment
140 2.01. This reserve is expected to remain an asset of the Corporation until such time as it
141 is no longer required and will then be available to offset debt service payments on the
142 Bonds. The reserve will also be invested and earn interest over time that will be used to
143 offset debt service requirements. While the fees included are significant, they must be
144 considered in the context of the transaction to which they relate and the services being
145 used. This is a multi-billion dollar securitization – the projected par value of the Bonds
146 to be issued approximately \$7 billion – involving securitized public debt, complex debt
147 exchanges, tax issues, and multiple classes of creditors with different interests, positions,
148 and rights. There is no possible way to execute a major restructuring of this size and
149 complexity without incurring transaction costs of this nature. The estimated costs are
150 consistent in type and, as a percentage of debt, in amount with other large restructuring
151 transactions and other large securitization transactions. Without incurring these costs it
152 would be impossible to complete the transaction, deliver its substantial net present value

153 and cash flow savings, and enable PREPA to restructure into a more modern, efficient
154 utility on the path to providing more cost-effective electric service to its Customers.

155 Q. **What would happen if these Financing Costs were not recovered through the**
156 **Transition Charges?**

157 A. They would have to be paid in some other manner (*e.g.*, by being charged directly to
158 customers) instead of being financed. That would not be a benefit to customers. Simply
159 put, any major restructuring and transformation – including the restructuring of PREPA
160 debt – will not happen by itself. And it is common and entirely appropriate to finance
161 those costs through proceeds of the Bonds.

162 IV. **CONCLUSION**

163 Q. **Does this conclude your written rebuttal testimony?**

164 A. Yes.

STATE OF NEW YORK
COUNTY OF KINGS
COUNTY CLERK'S OFFICE

SS:

I, Nancy T. Sunshine, County Clerk of the County of Kings, State of New York and also Clerk of the Supreme Court in and for said County and State, the same being a Court of Record and having a seal;

DO HEREBY CERTIFY THAT BAEZ, DENISE 01BA4980003
Term 4/8/2015 to 4/8/2019

Whose name is subscribed to the annexed affidavit, deposition, certificate of acknowledgment or proof, was at the time of taking the same a NOTARY PUBLIC in and for the State of New York, duly commissioned and sworn and qualified to act as such throughout the State of New York; that pursuant to law a commission, or a certificate of their official character, and autograph signature, have been filed in my office; that as such the Notary Public was duly authorized by the laws of the State of New York to administer oaths and affirmations, to receive and certify the acknowledgment or proof of deeds, mortgages, powers of attorney and other written instruments for lands, tenements and hereditaments to be read in evidence or recorded in this State, to protest notes and to take and certify affidavits and depositions; and that I am well acquainted with the handwriting of such Notary Public or have compared the signature on the annexed instrument with their autograph signature deposited in my office,

IN WITNESS WHERE OF, I have hereunto set my hand and affixed my official seal at Brooklyn, Kings County, New York on May 16, 2016



NANCY T. SUNSHINE
KINGS COUNTY CLERK

ATTESTATION

STATE OF NEW YORK)
) ss.
COUNTY OF NEW YORK)

The undersigned, MICHAEL MACE, being of legal age, married, executive and consultant, and resident of Waxhaw, North Carolina, in his capacity as Managing Director of Public Financial Management, Inc., states that the foregoing testimony, presented in written Question and Answer format, is true and correct to the best of his knowledge and belief.

IN WITNESS WHEREOF, I have hereunto signed my name this 16th day of May 2016.




MICHAEL MACE

Title: Managing Director
Public Financial Management, Inc.

Affidavit No. _____

Acknowledged and subscribed before me by Michael Mace, of the personal circumstances above mentioned, in his capacity as Managing Director of Public Financial Management, Inc., who is personally known to me, in New York City, New York County, New York, this 16th day of May 2016.



Notary Public
DENISE BAEZ
Notary Public, State of New York
No. 01BA4980003
Qualified in Kings County
Commission Expires April 8, 2019