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<b>JOINT REPORT AND APPLICATION</b>	<b>§</b>	<b>PUBLIC UTILITY COMMISSION</b>
<b>OF EL PASO ELECTRIC COMPANY,</b>	<b>§</b>	
<b>SUN JUPITER HOLDINGS LLC, AND</b>	<b>§</b>	<b>OF TEXAS</b>
<b>IIF US HOLDING 2 LP FOR</b>	<b>§</b>	
<b>REGULATORY APPROVALS UNDER</b>	<b>§</b>	
<b>PURA §§ 14.101, 39.262, AND 39.915</b>	<b>§</b>	

**REBUTTAL TESTIMONY**  
**AND EXHIBITS**  
**OF**  
**ELLEN LAPSON**  
**ON BEHALF OF**  
**SUN JUPITER HOLDINGS LLC**  
**AND**  
**IIF US HOLDING 2 LP**

**November 13, 2019**

**DOCKET NO. 49849**

**JOINT REPORT AND APPLICATION § PUBLIC UTILITY COMMISSION**  
**OF EL PASO ELECTRIC COMPANY, §**  
**SUN JUPITER HOLDINGS LLC, AND § OF TEXAS**  
**IIF US HOLDING 2 LP FOR §**  
**REGULATORY APPROVALS UNDER §**  
**PURA §§ 14.101, 39.262, AND 39.915 §**

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**EXHIBITS**

EL-R-1 Moody’s Investors Service, “Rating Action: Moody’s downgrades El Paso Electric to Baa2, outlook stable,” September 17, 2019

EL-R-2 Moody’s Investors Service, Credit Opinion, El Paso Electric Company, September 20, 2019

EL-R-3 Moody’s Investors Services, Announcement of Periodic Review, November 1, 2019

1

**GLOSSARY OF ACRONYMS AND DEFINED TERMS**

<b><u>Acronym/Defined Term</u></b>	<b><u>Meaning</u></b>
Cash Flow Leverage Metrics	Ratios used by credit rating agencies to assess debt leverage by comparison of the level of debt and debt-like liabilities with a measure of operating cash flow
Commission	Public Utility Commission of Texas
Company	El Paso Electric
EPE	El Paso Electric or Company
Fitch	Fitch Ratings
IIF	Infrastructure Investments Fund
IIF US 2	IIF US Holding 2 LP
Joint Applicants	EPE, Sun Jupiter, and IIF US 2
JPMIM	JP Morgan Investment Management
Moody's	Moody's Investors Service
NMPRC	New Mexico Public Regulatory Commission
S&P or S&P Global Ratings	Standard & Poor's
SACP	Stand-alone credit profile (a partial component of S&P's final credit rating of entities that are subsidiary companies and whose formal ratings are produced using S&P's consolidated rating methodology)
STM	Sale, Transfer, or Merger
Sun Jupiter	Sun Jupiter Holdings LLC
TCJA	Tax Cuts and Jobs Act of 2017
Proposed Transaction	Proposed acquisition of EPE by Sun Jupiter and IIF US 2

1  
2 **REBUTTAL TESTIMONY AND EXHIBITS OF ELLEN LAPSON**

3 **I. Introduction**

4 **Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.**

5 A. My name is Ellen Lapson, CFA. My business address is 370 Riverside Drive, New York,  
6 New York 10025.

7 **Q. DID YOU SUBMIT DIRECT TESTIMONY ON BEHALF OF SUN JUPITER AND**  
8 **HIF US 2 IN THIS PROCEEDING?**

9 A. Yes.

10 **Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?**

11 A. My rebuttal testimony responds to the direct testimony of the following witnesses with  
12 regard to the Joint Applicants' Proposed Transaction: John Antonuk on behalf of the Staff  
13 of the Public Utility Commission of Texas ("Commission"); Daniel J. Lawton on behalf of  
14 City of El Paso; Charles S. Griffey on behalf of Texas Industrial Energy Consumers; and  
15 James W. Daniel on behalf of Rate 41 Group. My rebuttal testimony deals with financial  
16 topics including debt leverage, financial risk, private equity, dividend policy, protective  
17 mechanisms (ring-fencing), and the implications of the Proposed Transaction on EPE's  
18 credit ratings and access to capital. If there are any aspects of these witnesses' direct  
19 testimony upon which I do not offer rebuttal, it does not signify my endorsement or  
20 agreement with the witnesses' testimony.

21 **Q. ARE YOU SPONSORING ANY EXHIBITS AS PART OF YOUR REBUTTAL**  
22 **TESTIMONY?**

23 A. Yes, I sponsor the exhibits listed in the Table of Contents of my rebuttal testimony.

24 **II. Executive Summary and Conclusions**

25 The Intervenor witnesses Mr. Daniel, Mr. Griffey, and Mr. Lawton and Staff  
26 witness Mr. Antonuk provide a distorted view of the Proposed Transaction, focusing on  
27 imagined risks and harms to EPE, while ignoring risks that EPE faces in the normal course

1 of its current existence and the benefits EPE's Board of Directors saw in unanimously  
2 choosing the Infrastructure Investments Fund ("IIF") as its partner.

3 Asserting that there are risks in the ownership of EPE by IIF US 2, a private  
4 investment company, the Intervenor and Staff witnesses completely ignore the risks and  
5 disadvantages that EPE faces in the status quo as a stand-alone entity. Those financial  
6 disadvantages include:

- 7 1. EPE is small and geographically concentrated;
- 8 2. Investors and analysts have limited time and attention span, and EPE's capital needs  
9 are too small to attract significant analytical coverage;
- 10 3. EPE is not an experienced issuer of common equity and would be disadvantaged as a  
11 small and infrequent issuer at raising new equity through public market equity issuance;
- 12 4. In the debt capital market, EPE cannot issue bonds in economic size in the public  
13 market (that is, index-sized issues of at least \$300 million), or it must delay its issuance  
14 of bonds in order to amass an efficiently-sized bond offering; and
- 15 5. Due to the specifics of its demographics and regulatory environments, EPE has  
16 relatively weak cash flow metrics when compared with other investor-owned U.S.  
17 electric utilities.

18 The Intervenor and Staff witnesses err in ignoring these special circumstances of  
19 EPE. The Proposed Transaction and private ownership by IIF US 2 is well-suited to EPE's  
20 special circumstances and EPE's anticipated increased funding needs. IIF US 2 can infuse  
21 equity into Sun Jupiter for investment in EPE in small amounts as capital is needed, without  
22 onerous transaction costs or dilutive discounts. The timing of such equity issuance is very  
23 flexible relative to public market issuance of equity.

24 The investors in IIF US 2 and in the equity of EPE have an intrinsic incentive to  
25 maintain EPE's financial integrity, contrary to the concerns of the Intervenor and Staff  
26 witnesses. Participants in IIF US 2 are long-term investors who are motivated to maintain  
27 and enhance the future value of their investment in EPE; degrading the financial condition  
28 of EPE would undermine the future value of EPE's equity and would be contrary to their  
29 interests as investors. These investors seek to purchase the equity of EPE because they  
30 foresee the opportunity to make ongoing equity investments in EPE rate base that will  
31 qualify for regulated return on investment. It is unreasonable to expect, as the opposing

1 witnesses do, that IIF US 2 will opt to withhold equity from EPE for projects that are  
2 prudent and eligible for inclusion in rate base.

3 The Intervenor and Staff witnesses assert troubling conflicts of interest will exist  
4 because Sun Jupiter and EPE will be unduly influenced by investors' desires to extract  
5 dividends. As I explained above, IIF US 2 investors are motivated to preserve the long-  
6 term value of their investment in EPE, and skimming excessive dividends out of the  
7 Company and reducing EPE's equity would undermine the long-term value. Furthermore,  
8 the witnesses ignore that the same conflicts they allege under the Proposed Transaction are  
9 no different from those in EPE's current situation; shareholders expect dividends over the  
10 long-term, whether they are public market shareholders or private investors in a fund like  
11 IIF US 2. Such pressures are present at all investor-owned utilities and are not unique to  
12 private ownership. Finally, one of the protective measures Joint Applicants propose would  
13 block the payment of a dividend if it would reduce EPE's equity capital below the  
14 authorized regulatory equity ratio, a protection that is not present today, and have also  
15 committed to a dividend blocker related to maintaining investment grade status. In  
16 summary, I do not see any validity in the supposed conflicts of interests suggested by Mr.  
17 Daniel, Mr. Griffey, and Mr. Antonuk.

18 The Intervenor witnesses exaggerate the impact of revolving credit debt at EPE and  
19 parent company debt at Sun Jupiter. While the Joint Applicants do indicate an intention to  
20 use a revolving credit facility at EPE and to add financial leverage at Sun Jupiter to fund  
21 the Proposed Transaction, my evaluation indicates that the credit ratings of EPE will be  
22 preserved at the current level of Baa2 (Moody's) and BBB (S&P). A significant factor in  
23 preserving mid-BBB credit ratings is the protective measures that the Joint Applicants  
24 outlined in their application. Moody's reports that it has considered and incorporated the  
25 forecasted debt at EPE and Sun Jupiter in their rating action announced on September 17,  
26 2019, in conjunction with the Joint Applicants' proposed ring-fencing. The Proposed  
27 Transaction will not alter the credit ratings of EPE (Baa2 Moody's) and is highly unlikely  
28 to alter S&P's current BBB issuer rating.

29 Mr. Griffey and Mr. Daniel disparage the protective regulatory conditions proposed  
30 by the Joint Applicants asserting that they are not as strong as or identical to those in the

1 Oncor Electric Delivery Company, LLC (“Oncor”)/Sempra Energy Inc. (“Sempra) order,<sup>1</sup>  
2 and Mr. Antonuk proposes replacing the Joint Applicants’ proposals with an entire set of  
3 ring-fencing provisions based upon the Oncor/Sempra stipulation in his Attachment JA-2.  
4 However, Texas statutes do not explicitly require utility ring-fencing and certainly do not  
5 specify that any protective measures must be identical in form to that incorporated in the  
6 Oncor/Sempra settlement. Contrary to the assertions of Mr. Daniel, Mr. Griffey, and Mr.  
7 Antonuk, each circumstance calls for different protective provisions that are tailored to the  
8 specific size and nature of the entity. Mr. Griffey cites supposed precedents from two STM  
9 settlements (Oncor/Sempra and Oncor/Sharyland/Sempra);<sup>2</sup> however, those precedents  
10 actually comprise two significantly different ring-fencing protocols that illustrate my  
11 conviction that the protective measures can and should come in different forms.  
12 Furthermore, there is no benefit to piling on multiple onerous conditions when simpler  
13 measures are better suited to EPE’s small size and circumstances and provide adequate  
14 protection.

15 Mr. Antonuk and Mr. Griffey seek to impose an onerous set of protective  
16 mechanisms some of which exceed those accepted by Sempra in the Oncor/Sempra  
17 transaction, ignoring the impractical burden of applying those measures to EPE, an entity  
18 only one-seventh the size of Oncor, and limiting EPE’s access to the benefits the EPE  
19 Board of Directors saw in pursuing the Proposed Transaction in the first place. For  
20 example, Mr. Griffey would require EPE to engage three credit rating agencies, versus the  
21 two agencies EPE has determined to be adequate to its needs at present. Furthermore, the  
22 proposals for a number of distinct boards of directors at EPE and various Sun Jupiter  
23 entities with a large number of outside directors would impose a disproportionate cost and  
24 governance burden in this case; the costs of outside directors and boards of directors do not  
25 vary with the size of the corporate entity, but those costs are far greater in proportion to the  
26 net income or assets of EPE versus Oncor.

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<sup>1</sup> See e.g., Griffey Direct at 26; Daniel Direct at 30.

<sup>2</sup> Griffey Direct at 26.



1 Finally, I recommend that the Commission approve the Proposed Transaction,  
2 including the Joint Applicants' proposed protective mechanisms with some enhancements  
3 or clarifications that the Joint Applicants introduce in their rebuttal testimony.

4 **III. EPE's Status Quo**

5 **Q. DO THE INTERVENOR AND STAFF WITNESSES ACKNOWLEDGE THAT**  
6 **EPE FACES CHALLENGES AND DISADVANTAGES AS A SMALL STAND-**  
7 **ALONE ENTITY?**

8 A. No, they do not. It appears that they believe public equity markets are an ATM and that  
9 EPE has all the benefits and options available to the largest companies in the utility sector,  
10 including unfettered, open access to public issuance of common equity and acceptance in  
11 the "broad capital market." Mr. Antonuk, for instance, dismisses the benefits that the Joint  
12 Applicants attribute to the Proposed Transaction, saying that Joint Applicants are unable  
13 to quantify the benefit of enhanced access to capital markets and that EPE will lose its  
14 ability to use public markets to secure equity capital.<sup>3</sup>

15 **Q. IS THAT CONSISTENT WITH YOUR VIEW?**

16 A. No. EPE is viewed in the financial marketplace as a minor entity within the utility sector  
17 and the greater economy. Moody's identifies the small size and geographical concentration  
18 of EPE's service territory as a financial and credit disadvantage. In its most recent report  
19 on EPE, Moody's states that "small size and scale constrain the credit profile," as follows:

20 [EPE's] credit profile also factors in its relatively small size and scale as  
21 well as market concentration as it serves about 428,000 customers in a small  
22 area of Texas and New Mexico.<sup>4</sup>

23 Furthermore, EPE is at a severe disadvantage in gaining the attention of fixed income and  
24 equity analysts and investors due to the small scale of the Company.  
25

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<sup>3</sup> Antonuk Direct at 26.

<sup>4</sup> Moody's Investors Service, "Rating Action: Moody's downgrades El Paso Electric to Baa2, outlook stable," September 17, 2019, attached hereto as Ex. EL-R-1.

1 **Q. HOW DOES EPE'S SIZE AND SCALE COMPARE WITH THAT OF ONCOR?**

2 A. EPE is only 14-15% of Oncor's size in terms of 2018 net income or total common equity  
3 at December 31, 2018.

4 **Table EL-R-1 Size Comparison**

	\$ millions	
	Net Income	Common Equity Book Value
	<u>2018</u>	<u>12/31/18</u>
Oncor	\$545	\$ 8,460
EPE	\$84	\$1,160
Ratio of EPE to Oncor	15%	14%

5

6 **Q. HOW DOES EPE COMPARE IN SIZE AND SCALE WITH OTHER INVESTOR-  
7 OWNED UTILITIES?**

8 A. Exhibit EL-2 to my direct testimony shows EPE's equity market capitalization relative to  
9 52 companies in the North American utility sector. It is instructive to review that  
10 information, as I do below in Table EL-R-2. EPE represented only 0.3% of the total equity  
11 market cap of the 52 investor-owned utilities captured in this sample, a marketplace in  
12 which the top ten companies are giants that in aggregate have 54% of the entire market  
13 capitalization.

**Table EL-R-2 Equity Market Capitalization (1)**

<b>Utilities Ranked by Size</b>	<b>Equity Market Cap. (US \$ Billions)*</b>	<b>Percent of Total Market Capital</b>	<b>Percentage of Aggregate Market Capital</b>
Top 10 Utilities	\$498	54%	54%
11 through 20	\$216	23%	77%
21 through 30	\$119	13%	90%
31 through 40	\$52	6%	96%
41 through 52	\$38	4%	100%
Total 52 Utilities	\$924	100%	100%
El Paso Electric	\$2.7	0.3%	0.3%

Rank = #48

(1) Derived from: Exhibit EL-2, Lapson Direct Testimony

Source: Bank of America Merrill Lynch \*Data as of July 26, 2019

1

2 **Q. HOW DOES ITS RELATIVELY SMALL SIZE PLACE EPE AT A**  
3 **DISADVANTAGE IN THE EQUITY CAPITAL MARKET?**

4 A. Investors and analysts cannot afford the time and energy to follow all the companies in the  
5 market, so financial institutions and investors concentrate their attention on a small number  
6 of companies in any sector. There is a tendency in the investment community to focus on  
7 those companies that are the most active issuers and come to market with securities  
8 frequently. The securities of those companies tend to have the greatest market liquidity  
9 and the most analytical coverage. EPE's capital needs are too small to attract significant  
10 analytical coverage.

11 **Q. DOES EPE FACE ANY SIZE DISADVANTAGE IN THE DEBT CAPITAL**  
12 **MARKET?**

13 A. Yes. EPE is at a disadvantage in bringing to the public market bonds in economic size.  
14 Investors prefer to buy bonds that are issued in index-sized issues eligible for inclusion in  
15 the major bond indices, which requires each bond issue to be at least \$300 million. EPE's  
16 bond issues over recent years averaged in the range of \$100 to \$150 million, and as a  
17 consequence, EPE pays higher interest rates when it issues bonds than would be the case  
18 for a larger utility with a larger scale of issuance.

1 **Q. DOES EPE ENJOY EASY AND OPEN ACCESS TO THE BROAD CAPITAL**  
2 **MARKET AT PRESENT?**

3 A. No, I would not agree with that view.

4 **Q. WOULD THE PROPOSED TRANSACTION PROVIDE BENEFIT TO EPE**  
5 **RELATIVE TO THE STATUS QUO IN TERMS OF ACCESS TO CAPITAL?**

6 A. Yes. As discussed by Mr. Gilbert, since 2006, IIF has continually and successfully raised  
7 equity from institutional investors to fund capital projects across its portfolio  
8 companies. For the 12 months ending June 30, 2019, IIF received \$5.4 billion in new  
9 commitments, reinvested distributions from investors, and invested approximately \$2.8  
10 billion of equity into its existing portfolio companies and in new acquisitions. IIF  
11 (including IIF US 2) has never been in a position of having less capital available than  
12 funding requests from its portfolio companies, including through the global financial crisis  
13 in 2008. Additionally, since June 30, 2017, IIF portfolio companies have closed, on  
14 average, approximately \$4 billion of debt facilities per year through new financing or  
15 refinancing activities. By comparison, EPE closed on average approximately \$320 million  
16 of debt facilities per year over the same period. Therefore, I see this as a meaningful  
17 enhancement to EPE's future access to equity and debt capital.

18 **IV. Private Equity**

19 **A. Alleged Risks of Private Equity**

20 **Q. WHAT RISKS DO THE WITNESSES ASCRIBE TO PRIVATE EQUITY**  
21 **OWNERSHIP OF EPE?**

22 A. Mr. Daniel asserts that the Proposed Transaction poses risks because private equity  
23 ownership by IIF US 2 is intrinsically risky. He asserts that "illiquid private equity  
24 investors tend to expect higher returns than a traditional utility realizes, driving an appetite  
25 for additional risk and debt leverage."<sup>5</sup>

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<sup>5</sup> Daniel Direct at 17.

1 **Q. WHAT AUTHORITY DOES MR. DANIEL CITE FOR THIS BELIEF ABOUT**  
2 **THE ILLIQUIDITY OR HIGH RETURN EXPECTATIONS OF PRIVATE**  
3 **EQUITY INVESTORS?**

4 A. He cites no sources, and it appears to me that he has confused private equity investors with  
5 venture capital providers, an entirely different style of investment.

6 **Q. WHAT IS YOUR RESPONSE TO MR. DANIEL'S ASSERTIONS?**

7 A. Mr. Daniel errs in suggesting that private equity investors such as pension funds, insurers,  
8 and managers of estates or endowments demand higher returns and wish for greater risks  
9 from utility investments than these same investors do when they invest in public market  
10 securities. When major investors invest in a utility or a contracted wind farm or power  
11 asset through IIF, they are seeking stable investment with low correlation to the  
12 industrial/financial cycle. They are not seeking to plunder and pillage companies, as Mr.  
13 Daniel presumes.

14 **Q. MR. DANIEL ALSO ASSERTS THAT PRIVATE EQUITY INVESTORS AND**  
15 **THEIR REPRESENTATIVES ON THE BOARD OF EPE ARE LIKELY TO PRESS**  
16 **FOR HIGH DIVIDEND PAYMENTS, DAMAGING EPE CREDIT RATINGS AND**  
17 **RISKING HIGHER COSTS FOR RATEPAYERS.<sup>6</sup> PLEASE RESPOND.**

18 A. In my experience in the financial market, private equity owners strive to maximize total  
19 return, which includes realizing the longer-term value of their investment and not just  
20 current dividends, as Mr. Daniel suggests. The long-term value of their investment in EPE  
21 would be jeopardized by drawing excessive funds from the utility or starving it for capital  
22 and thus degrading the strength of the utility and losing the acceptance of the Commission  
23 and customers.

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<sup>6</sup> *Id.* at 17-18.

1 **Q. MR. DANIEL ALSO ASSERTS THAT PRIVATE EQUITY AVOIDS REPORTING**  
2 **AND REGULATORY REQUIREMENTS SUCH AS SARBANES-OXLEY THAT**  
3 **PROTECT INVESTORS AND RATEPAYERS.<sup>7</sup> DO YOU AGREE?**

4 A. No. As far as regulatory accounting is concerned, EPE will continue to be subject to the  
5 accounting rules of the Commission and the Federal Energy Regulatory Commission  
6 Uniform System of Accounts. Furthermore, since EPE has outstanding long-term bond  
7 issues and expects to continue to issue long-term bonds in the future, it is possible that EPE  
8 will file Securities and Exchange Commission financial statements prepared in accordance  
9 with Generally Accepted Accounting Principles and subject to all the same rules and  
10 regulations as at present.

11 **Q. MR. GRIFFEY ASSERTS THAT IIF US 2 WILL BE MOTIVATED TO INCREASE**  
12 **CAPITAL INVESTMENTS AND TO PURSUE UNNECESSARY AND**  
13 **INEFFICIENT PROJECTS THAT WILL NOT PROVIDE SERVICE AT THE**  
14 **LOWEST COST TO EPE'S CUSTOMERS.<sup>8</sup> IS THIS A REASONABLE**  
15 **CONCERN?**

16 A. No, it is not. Capital investments are subject to the Commission's review for inclusion in  
17 rate base. It would be foolhardy and reckless for IIF US 2 to cause EPE to make  
18 unnecessary investments that would be denied recovery and return by the Commission.  
19 For any major investments, EPE would be likely to seek approval in advance from the  
20 Commission to assure recovery or would be very conservative and cautious in order to  
21 avoid the risk of imprudence disallowance.<sup>9</sup>

22 Similarly, Mr. Griffey asserts that "Joint Applicants' commitment to support New  
23 Mexico's Energy Transition Plan, oral comments as to a 'switch to renewables,' and a  
24 focus on ESG 'best practices' all could indicate a bias toward high capital cost resources."<sup>10</sup>  
25 This is a specious argument, for the reason I just cited. It is doubtful that there is any  
26 pension fund, insurance company, or other institutional member of IIF US 2 that intends

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<sup>7</sup> *Id.* at 17.

<sup>8</sup> Griffey Direct at 22, 24.

<sup>9</sup> Mr. Griffey acknowledges this very point at 24:17-20.

<sup>10</sup> Griffey Direct at 24.

1 to make wasteful investments that are unlikely to earn a return of and return on investment.  
2 Second, Mr. Griffey seems to place a low degree of confidence in the Commission's ability  
3 to carry out its regulatory mandate.

4 **B. Alleged Governance Risks and Access to Equity Capital**

5 **Q. MR. GRIFFEY AND MR. ANTONUK EXPRESS CONCERNS BECAUSE IIF US 2**  
6 **HAS NOT REVEALED THE NAMES OF ITS INVESTORS AND BECAUSE IT**  
7 **DOES NOT INTEND TO DO SO OVER TIME.<sup>11</sup> IS THIS A SOURCE OF**  
8 **CONFLICT OR GOVERNANCE RISK?**

9 A. No. EPE's public equity investors currently are entities or individuals whose identities are  
10 not reported to the Commission, and shareholders can buy and sell shares at any time  
11 without the permission or knowledge of the Commission. As of June 30, 2019, IIF US 2  
12 had 517 investors; the average investment holding, therefore, was just under 0.2%, and the  
13 largest holding at that date was less than 5%.<sup>12</sup> The situations under both ownership  
14 structures are parallel. Mr. Antonuk suggests that the Staff or the Commission needs to  
15 know the identity of larger holders to assess if there are conflicting or competing interests  
16 on the part of the members of IIF US 2, but in reality there is not any material difference  
17 or increased possibility for conflicts of interest under EPE's current structure and under the  
18 Proposed Transaction.

19 **Q. MR. GRIFFEY ASSERTS THAT THERE WILL BE CONFLICTS OF INTEREST**  
20 **REGARDING HOW J.P. MORGAN INVESTMENT MANAGEMENT ("JPMIM")**  
21 **AND IIF US 2 WILL MANAGE EPE. FOR EXAMPLE, HE ASSERTS THAT IIF**  
22 **US 2 WILL BE MOTIVATED TO INCREASE LEVERAGE AT EPE TO SUPPORT**  
23 **A TARGET RETURN TO IIF US 2'S INVESTORS, AND NOT TO SUPPORT THE**  
24 **CAPITAL NEEDS OR INTEGRITY OF EPE.<sup>13</sup> WHAT IS YOUR RESPONSE?**

25 A. As an initial matter, I disagree with the premise of the statement that EPE will be managed  
26 by JPMIM or IIF US 2. As Mr. Gilbert describes in his direct and rebuttal testimony, EPE

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<sup>11</sup> Griffey Direct at 20; Antonuk Direct at 9.

<sup>12</sup> IIF US 2 response to TIEC 1-1.

<sup>13</sup> Griffey Direct at 20.

1 will be managed by its management team and a majority independent board of directors.  
2 In any event, it would be foolish for any owner of a utility to not support the capital needs  
3 of the utility. As I mentioned earlier in my rebuttal testimony, the long-term value of the  
4 investment in EPE is in supporting the capital needs of EPE to maintain a strong utility and  
5 to maintain good working relationships with customers, the Commission, and all interested  
6 stakeholders. Furthermore, Mr. Griffey appears to dismiss the role of the Commission and  
7 the oversight that it provides to every utility.

8 **Q. MR. ANTONUK, MR. GRIFFEY, AND MR. DANIEL ASSERT THAT EPE MAY**  
9 **BE DEPRIVED OF EQUITY CAPITAL IF IIF US 2 OR ITS INVESTORS CHOOSE**  
10 **NOT TO INVEST EQUITY IN PROJECTS THAT THE EPE BOARD OF**  
11 **DIRECTORS INTEND TO FUND.<sup>14</sup> MR. GRIFFEY AND MR. ANTONUK BOTH**  
12 **EXPRESS CONCERNS THAT EPE’S OPTION FOR SECURING EQUITY**  
13 **CAPITAL GOING FORWARD WILL BE RESTRICTED TO THE WILLINGNESS**  
14 **OF IIF US 2 AND ITS MEMBERS, INSTEAD OF HAVING ACCESS TO**  
15 **FUNDING EQUITY IN THE BROADER CAPITAL MARKET.<sup>15</sup> IS THIS A**  
16 **VALID CONCERN?**

17 **A.** No. First, it is reasonable to assume that the Commission will authorize rates that are likely  
18 to produce a return on investment commensurate with the associated risks (that is,  
19 competitive with returns available in the market on investments with comparable risk), as  
20 is the Commission’s responsibility. If this is so, then IIF US 2 will be motivated to invest  
21 in EPE to the same extent or a greater extent than investors at large in the public market.  
22 Second, Mr. Griffey and Mr. Antonuk err when they suggest that EPE currently has open  
23 and unlimited access currently to the “broader capital market” to meet any equity needs.  
24 In reality, EPE is a small and relatively unknown participant in the equity capital market,  
25 and its ability to raise new capital in the equity market has been untested for many years.  
26 Even under benign financial market conditions, EPE has not issued any common equity,  
27 and during any period of financial market constraints, EPE would have little chance of  
28 issuing new equity at favorable terms in the public market. IIF US 2 is likely to be a more

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<sup>14</sup> See e.g., Antonuk Direct at 24-25; Griffey Direct at 20.

<sup>15</sup> Griffey Direct at 21; Antonuk Direct at 25.



1 assured and more convenient source of funding to EPE than the public market under both  
2 benign and constrained market conditions.

3 **Q. ACCORDING TO MR. DANIEL THE COMMISSION WILL RETAIN**  
4 **AUTHORITY TO APPROVE CAPITAL IMPROVEMENTS BUT WILL NOT**  
5 **HAVE AUTHORITY TO ENFORCE ORDERS REQUIRING THE UPSTREAM**  
6 **OWNERS TO FUND NEEDED IMPROVEMENTS.<sup>16</sup> IS THIS A VALID**  
7 **CONCERN?**

8 **A.** No. The situation that Mr. Daniel describes is no different from EPE's current situation.  
9 Under the status quo, the Commission has no authority to require that EPE approach the  
10 equity market to obtain new equity, nor any authority to compel the public market to supply  
11 equity funding to EPE. Attracting equity investment results from the Commission's  
12 decisions to set rates at a level that provides equity investors the opportunity to earn a return  
13 that is competitive with the returns available in the market for investments of comparable  
14 risk. The Commission cannot directly compel investment under the current ownership  
15 structure and the change in ownership will not alter that condition. Even so, IIF US 2 has  
16 committed to five years of continued funding of EPE's capital improvement plan, subject  
17 to Commission review. This is a commitment that does not currently exist.

## 18 **V. Financial Leverage**

### 19 **A. EPE Debt Leverage and Dividends**

20 **Q. WILL THE PROPOSED BORROWING UNDER A \$400 MILLION REVOLVING**  
21 **CREDIT AGREEMENT AT EPE CONSTITUTE A SOURCE OF UNUSUAL RISK**  
22 **OR EXCESSIVE LEVERAGE AT EPE, AS CERTAIN WITNESSES ASSERT?**

23 **A.** No. Borrowing under revolving credit arrangements (or via short-term commercial paper  
24 notes backed by an unused revolving credit facility) is a common practice of companies in  
25 the utility sector. Despite the assertion by Mr. Griffey and Mr. Lawton that drawing under  
26 the credit agreement is tied in some way to EPE's future dividend payments,<sup>17</sup> I can find  
27 absolutely no evidence of any linkage between EPE revolving credit draws and EPE's

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<sup>16</sup> Daniel Direct at 18.

<sup>17</sup> Griffey Direct at 18-19; Lawton Direct at 21-22.

1 dividend policy. Typically, utilities use drawings under their revolving credit and  
2 commercial paper arrangements to fund capital expenditures, bridge intervals between  
3 bond issues, fund tax payments, and manage seasonal variations in cash flow including  
4 quarterly dividend payments. That appears to be the case at EPE. Finally, drawing under  
5 the revolving credit facility is consistent with maintaining EPE's current ratings of BBB  
6 (S&P) and Baa2 (Moody's).

7 **Q. THE COMMISSION'S RATE-SETTING PRACTICE IS TO AUTHORIZE A**  
8 **CAPITAL STRUCTURE COMPRISED OF TARGET RATIOS OF EQUITY AND**  
9 **LONG-TERM DEBT. DOES THE PLANNED SHORT-TERM BORROWING AT**  
10 **EPE CONSTITUTE A REGULATORY LOOPHOLE OR EVASION OF THE**  
11 **CAPITAL STRUCTURE AUTHORIZED BY THE COMMISSION?<sup>18</sup>**

12 A. No. The Commission's policy of setting rates based upon a capital structure of equity plus  
13 long-term debt is long-standing and well established, and the presence of short-term debt  
14 that is explicit on the balance sheets of some or many jurisdictional utilities is neither a  
15 secret nor a form of evasion.

16 **Q. PLEASE RESPOND TO MR. LAWTON'S CONTENTION THAT IIF US 2 PLANS**  
17 **TO INCREASE THE DIVIDEND PAYOUT RATIO MATERIALLY IN ORDER**  
18 **TO DRIVE CASH FLOW UPSTREAM.<sup>19</sup>**

19 A. I understand that Mr. Lawton is referring to a financial model supplied in response to a  
20 discovery request. That model keeps EPE's equity at the proportion authorized by the  
21 Commission for rate-setting by paying out net income as a dividend and simultaneously  
22 reinvesting equity in the amount needed to maintain the target equity level. This is a  
23 modeling convention. The salient fact is that EPE's equity is consistently maintained at  
24 the level that the Commission has authorized.

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<sup>18</sup> As alleged by Mr. Griffey at 18-19.

<sup>19</sup> Lawton Direct at 21-22.

1           **B.     Debt at Sun Jupiter Entities**

2   **Q.     WILL THE PROPOSED DEBT AT SUN JUPITER CREATE EXCESS**  
3   **LEVERAGE THAT WILL AFFECT EPE’S FINANCIAL STRENGTH?**

4   A.     The expected debt amount of \$700 million at Sun Jupiter (that is, a \$625 million term loan  
5           and \$75 million revolving credit) is a reasonable amount of leverage. I disagree with Mr.  
6           Griffey’s assertion that the consolidated entity of EPE and Sun Jupiter will be a “highly  
7           leveraged” entity.<sup>20</sup>

8   **Q.     SEVERAL WITNESSES QUESTION THE INTENTION BEHIND PLACING**  
9   **THREE SUN JUPITER ENTITIES ABOVE SUN JUPITER HOLDINGS LLC AND**  
10 **EXPRESS CONCERNS THAT DEBT LEVERAGE WILL BE ADDED AT THOSE**  
11 **ENTITIES.<sup>21</sup> WHAT IS YOUR RESPONSE**

12 A.     As I also discuss below, Joint Applicants have added additional commitments that address  
13           these concerns including a commitment that dividends will be suspended if EPE’s credit  
14           rating falls below investment grade and a restriction around third-party debt at the Sun  
15           Jupiter Entities above Sun Jupiter Holdings LLC. I believe that these commitments  
16           adequately address the concerns raised.

17           **C.     Effect upon Credit Ratings**

18 **Q.     PLEASE EXPLAIN WHY YOU STATE THAT THE TRANSACTION AND**  
19 **LEVERAGE AT SUN JUPITER WILL NOT ADVERSELY AFFECT EPE’S**  
20 **CREDIT RATINGS.**

21 A.     First, Moody’s has already published its review of EPE’s credit that considers the Proposed  
22           Transaction including the planned short-term debt at EPE and term debt at Sun Jupiter in a  
23           report of a rating action dated September 17, 2019 and in a Credit Opinion dated September  
24           20, 2019. In the rating action of September 17, Moody’s announced that it had lowered  
25           EPE’s rating from Baa1 to Baa2.<sup>22</sup> Moody’s analyst explained that the primary driver of  
26           the downgrade is Moody’s expectation of lower cash flow credit metrics as a result of

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<sup>20</sup> Griffey Direct at 16-17.

<sup>21</sup> See e.g., Antonuk Direct at 35-36; Griffey at 6.

<sup>22</sup> See Ex. EL-R- 1.

1 higher capital expenditures and reduced cash flow due to tax reform and loss of bonus  
2 depreciation, factors that are not contingent on the Proposed Transaction. The rating  
3 decision also considers the impact of the acquisition of EPE by IIF US 2, stating that  
4 Moody's stable rating outlook for EPE is supported by: (1) the planned funding of the  
5 transaction primarily with equity and without acquisition debt at EPE; (2) the ring-fencing  
6 commitments proposed by the Joint Applicants; and (3) the commitment to preserve the  
7 regulatory capital structure of EPE. The Credit Opinion published by Moody's on  
8 September 20, 2019 reiterates these themes.<sup>23</sup> On November 1, 2019, Moody's issued an  
9 announcement of completion of its periodic review of EPE's credit rating with no further  
10 action.<sup>24</sup>

11 **Q. IS THERE A SIMILAR ASSURANCE OF EPE'S RATING BY S&P IN RESPONSE**  
12 **TO THE PROPOSED TRANSACTION?**

13 A. No, as of the current time, S&P has not published anything as definitive as Moody's. The  
14 last and only commentary by S&P was a research update on June 5, 2019 when the  
15 acquisition was announced. In that report, S&P affirmed its BBB rating of EPE but revised  
16 the outlook to Negative from Stable. This is a very common reaction by credit rating  
17 agencies to a merger or acquisition announcement. S&P stated that it would "continue to  
18 monitor the regulatory approval process and assess the planned funding strategy for EPE  
19 and its proposed intermediary holding company as it develops."<sup>25</sup> In light of the strong  
20 ring-fencing commitments that have been proposed by the Joint Applicants and some  
21 clarifications and enhancements that the Joint Applicants have made in their rebuttal  
22 testimony, S&P is highly likely to affirm the credit ratings of EPE at BBB prior to the  
23 closing of the Proposed Transaction. While the additional debt at Sun Jupiter will be  
24 calculated as contributing to higher consolidated debt leverage for the combined entity,

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<sup>23</sup> Moody's Investors Service, Credit Opinion, El Paso Electric Company, September 20, 2019, attached as Ex. EL-R-2.

<sup>24</sup> Moody's Investors Service, "Announcement of Periodic Review, Nov. 1, 2019, attached hereto as Ex. EL-R-3.

<sup>25</sup> S&P Global Ratings, "Research Update: El Paso Electric Co. Outlook Revised to Negative from Stable on Acquisition by IIF; Ratings Affirmed," June 5, 2019.

1 S&P's rating methodology will give significant credit to the insulation and protections  
2 afforded to EPE via the proposed ring-fencing provisions and regulatory commitments.

3 **Q. MR. LAWTON ASSERTS THAT "GIVEN THE RECENT BOND DOWNGRADE**  
4 **BY MOODY'S, THERE EXISTS A SUBSTANTIAL POSSIBILITY THAT EPE'S**  
5 **DEBT COSTS AND COSTS TO CUSTOMERS WILL BE HIGHER UNDER THE**  
6 **PROPOSED TRANSACTION."**<sup>26</sup> **HOW DO YOU RESPOND?**

7 A. Mr. Lawton appears to be confused about the nature and significance of Moody's ratings  
8 action. Moody's had assigned a negative credit outlook to EPE in March 2018 "due to an  
9 expectation for weaker financials, driven by reduced cash flows associated with tax reforms  
10 under the Tax Cut and Jobs Act, higher capital expenditures, and an increased dividend."<sup>27</sup>  
11 These are essentially the same factors Moody's cited for the credit downgrade from Baa1  
12 to Baa2 on September 17, 2019. There is no indication that the rating downgrade results  
13 from the Proposed Transaction nor that the rating would be revised upward again if the  
14 Proposed Transaction does not occur. Thus, if there is any impact from Moody's  
15 downgrade from Baa1 to Baa2, it is not an effect of the Proposed Transaction.  
16 Furthermore, there is not likely to be much difference in the eyes of bond buyers of a rating  
17 of Baa1 with Negative Outlook (the prior rating) versus a rating of Baa2 with Stable  
18 Outlook (the new rating). Mr. Lawton's line of reasoning is specious.

19 **D. Alleged Risk of Failure**

20 **Q. MR. LAWTON IMPLIES THAT THE PROPOSED TRANSACTION IS AKIN TO**  
21 **"PAST ACQUISITIONS AND CREATIVE FINANCIAL TRANSACTIONS**  
22 **[THAT] FAILED IN THE PAST, RESULTING IN ADDED RISKS AND HARMS**  
23 **TO CUSTOMERS."**<sup>28</sup> **DO YOU FIND ANY PARALLELS BETWEEN THIS**  
24 **TRANSACTION AND THOSE THAT MR. LAWTON CITES?**

25 A. No. One spurious parallel that Mr. Lawton suggests is the 1986 and 1989 sale-leasebacks  
26 of the Palo Verde Nuclear Stations Units 2 and 3, which contributed to EPE's bankruptcy.

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<sup>26</sup> Lawton Direct at 3.

<sup>27</sup> Moody's Investor Service, Issuer Comment, El Paso Electric Company, June 5, 2019.

<sup>28</sup> Lawton Direct at 12-13.

1 Unlike the leveraged leases of the two nuclear generating units, the Proposed Transaction  
 2 is very simple. A major factor in EPE's bankruptcy in 1991 was that the capacity of those  
 3 two nuclear units was costly and excessive relative to EPE's projected consumption and  
 4 the needs of others in the western region. I see no relationship between that situation and  
 5 the Proposed Transaction.

6 Mr. Lawton's second spurious parallel is "a merger acquisition financed primarily  
 7 by debt ending in financial failure," by which he presumably refers to the formation of  
 8 Energy Future Holdings and its buyout of TXU Corp. Unlike EPE, TXU Corp. was not  
 9 primarily a vertically integrated utility; it was a massive competitive power generation  
 10 company and a competitive retail energy marketer. This Proposed Transaction is primarily  
 11 funded by equity and includes only a moderate amount of acquisition debt added at Sun  
 12 Jupiter; the Energy Future Holdings buy-out was a highly leveraged transaction funded  
 13 with 89% debt and only 11% equity. The success of that transaction depended upon a  
 14 speculative forecast of rising gas and power prices, while the opposite actually occurred.  
 15 The Proposed Transaction is not a highly leveraged acquisition and does not share any of  
 16 those characteristics. If anything, Mr. Lawton's suggested parallels merely highlight that  
 17 the Proposed Transaction is a conservative transaction not materially different from other  
 18 merger and acquisition transactions, and that it is at the low end of the risk spectrum.

## 19 VI. Protective Mechanisms (Ring-Fencing)

### 20 A. Joint Applicants' Proposed Protective Mechanisms

21 **Q. HAVE THE JOINT APPLICANTS MADE ANY MODIFICATIONS OR**  
 22 **ENHANCEMENTS TO THE PROPOSED RING-FENCING PROVISIONS**  
 23 **INCLUDED IN THEIR ORIGINAL APPLICATION?**

24 **A.** Yes. The Joint Applicants' have made a number of modifications or enhancements to the  
 25 proposed ring-fencing after reviewing the testimony of the intervenors and Staff. While I  
 26 believe the original ring fence as proposed in the application is sufficient, the additional  
 27 commitments made by Joint Applicants address some of the concerns raised in testimony.  
 28 First, Joint Applicants have agreed to a dividend stopper if EPE's credit rating falls below  
 29 investment grade for EPE senior unsecured debt at two of the major rating agencies.  
 30 Second, Joint Applicants have committed that none of the Sun Jupiter Entities (excluding

1 Sun Jupiter) will incur any third-party debt absent Commission approval. Third, Joint  
2 Applicants have made a commitment around EPE and Sun Jupiter's ability to borrow  
3 money from IIF US 2 and JP Morgan.

4 **Q. WHAT IS YOUR REACTION TO THE MODIFICATIONS THAT THE JOINT**  
5 **APPLICANTS ARE PROPOSING?**

6 A. While I believe that the ring-fencing provisions contained in the original application are  
7 sufficient to protect EPE from any risks associated with the Proposed Transaction, I believe  
8 that these additional commitments adequately address the concerns raised by various  
9 witnesses around debt levels above EPE, ensuring the financial health of EPE, and ensuring  
10 arm's-length dealings with JP Morgan.

11 **Q. WHAT IS YOUR OVERALL ASSESSMENT OF THE JOINT APPLICANTS'**  
12 **PROPOSED RING-FENCING COMMITMENTS AS THEY NOW STAND?**

13 A. The commitments that the Joint Applicants have proposed, including the clarifications and  
14 modifications I discuss above, are consistent with the standards for strong and robust  
15 protection of a rate-regulated utility. When taken together with the powers of the  
16 Commission to oversee the affairs and rates of EPE, these commitments will result in a  
17 high level of protection for the utility.

18 **B. Critique of Witnesses' Recommendations**

19 **1. Critique of Mr. Antonuk's Proposal**

20 **Q. WHAT IS YOUR GENERAL RESPONSE TO THE SET OF RING-FENCING**  
21 **CONDITIONS THAT MR. ANTONUK PROPOSES ON BEHALF OF STAFF?**

22 A. While some items in Mr. Antonuk's proposal are reasonable and similar to conditions that  
23 the Joint Applicants have proposed, many conditions proposed by Mr. Antonuk are  
24 extremely over-reaching and far exceed the reasonable measures that are available to  
25 safeguard EPE. Second, the proposed conditions regarding credit ratings and the issuance  
26 of debt and equity suggest a poor understanding by Mr. Antonuk of the realities of credit  
27 rating agencies, debt and equity markets, normal terms of lending, and normal treasury  
28 practices. Third, it is evident that some conditions that conform to the circumstances of  
29 Oncor do not fit well with the individual circumstances of EPE. Finally, piling on more

1 and more conditions does not produce better protection. It is simpler for EPE's Board of  
2 Directors, the Commission, and the Staff to monitor compliance with a more compact set  
3 of conditions such as those proposed by the Joint Applicants, and the prospect for  
4 compliance with a condensed and simpler set of protective conditions is greater.

5 I respond to conditions proposed by Mr. Antonuk in the following areas: credit  
6 ratings; debt, and the powers of EPE directors regarding the issuance of debt and equity;  
7 solvency and bankruptcy; affiliate relationships and code of conduct; books and records;  
8 and additional agreements. Other witnesses on behalf of Joint Applicants may provide  
9 their responses on these or other conditions. If I fail to comment on any condition proposed  
10 by Mr. Antonuk, it does not imply that I agree with that condition.

11 **Q. DO YOU HAVE ANY RESPONSE REGARDING MR. ANTONUK'S**  
12 **CONDITIONS 7D THROUGH 7F OF ATTACHMENT JA-2 REGARDING**  
13 **POWERS OF THE EPE DIRECTORS?**

14 **A.** Yes. Conditions 7d through 7f as written are muddled and demonstrate a lack of  
15 understanding of equity issuance procedures. Mr. Antonuk may believe that the General  
16 Partner of IIF US 2 will raise debt on behalf of EPE or provide debt funding to EPE, but  
17 this is not the case. EPE will continue to raise debt funding through its own treasury  
18 operations.

19 IIF US 2 plans to supply equity infusions to EPE. It would not be convenient,  
20 timely, or cost-efficient for EPE to enter the public market to issue equity, and I do not  
21 believe that this could ever be viewed as a probable or normal circumstance. Activating  
22 this option would require EPE to register shares. After registration, the shares so issued  
23 would be a small minority non-controlling interest and are unlikely to be traded on a major  
24 stock exchange.<sup>29</sup> Issuance would be at a significant discount to value due to the shares'  
25 illiquidity and lack of control, and the costs of issuance would be very high. This option  
26 is perhaps in the realm of fantasy. Finally, Condition 7g is in direct conflict with Condition  
27 13a, which would bind Sun Jupiter Entities and IIF US 2 to continue to hold 100 percent  
28 of the ownership of EPE for ten years.

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<sup>29</sup> The shares so issued might be traded on OTC Pink, the successor to the former Pink Sheets, or on OTC BB, an electronic bulletin board.



1           In an attempt to address Mr. Antonuk's position, however, Joint Applicants have  
2 proposed a number of new commitments to provide comfort that EPE will have the  
3 resources it needs. In particular, Joint Applicants committed that it can seek other  
4 opportunities for equity under certain conditions if IIF US 2 declines to provide the equity  
5 requested by EPE.

6 **Q. CAN YOU PLEASE COMMENT ON MR. ANTONUK'S CONDITIONS**  
7 **REGARDING CREDIT RATINGS (CONDITIONS 8A THROUGH 8D OF**  
8 **ATTACHMENT JA-2)?**

9 A. Yes.

- 10 • Condition 8a: This condition posits a commitment that the credit ratings of EPE at  
11 S&P and Moody's will remain at or above the ratings as of November 1, 2019. This is  
12 an impractical and unrealistic commitment, since it is impossible to control the changes  
13 the rating agency may make in EPE's ratings. For example, even if EPE's financial  
14 metrics remain absolutely constant, a rating agency may alter its benchmarks or its  
15 rating methodology. Furthermore, a rated company may experience a ratings  
16 downgrade in direct response to an unfavorable decision by a regulatory authority.  
17 Thus, EPE would not have any means to assure the fulfillment of such a commitment.
- 18 • Condition 8b: This condition states that EPE will obtain or maintain ratings with major  
19 rating agencies including S&P and Moody's. Since EPE is already rated by both of  
20 these agencies, it is not a problem in the near term. However, over time, there may be  
21 a legitimate reason to favor a different rating agency over either of those two agencies,  
22 the two agencies could merge, or investors may come to esteem another agency. Also,  
23 it is anticompetitive to embody in long-lived documents such as these regulatory  
24 conditions that provide a perpetual franchise for two particular credit rating agencies.  
25 Therefore, it would be better to make the commitment in the form that EPE will  
26 maintain ratings from at least two nationally recognized credit rating agencies as Joint  
27 Applicants have proposed.
- 28 • Condition 8c: I believe the first sentence of 8c is acceptable if it means that EPE's  
29 owners must ensure the existence of credit ratings and debt ratings in EPE's individual  
30 name. The remainder of this condition is not practical as it appears to dictate what

1 credit rating methodology each credit rating agency will employ. The rated company  
2 has no control over the methodology employed by the rating agency, so the second part  
3 of the condition is problematic.

- 4 • Condition 8d: This condition is quite inappropriate for EPE and is more likely a  
5 holdover copied from the conditions accepted by Oncor/Sempra. The condition as  
6 written speaks to the senior secured debt ratings of EPE, but EPE has no senior secured  
7 ratings. EPE has only senior unsecured debt ratings, which are currently BBB by S&P  
8 and Baa2 by Moody's. It is unreasonable to set a rating threshold that is at the current  
9 level, such that a downgrade of even a single notch by either agency would activate the  
10 dividend block. As I have already mentioned, EPE cannot control the ratings issued by  
11 rating agencies, and, for example, a one-notch downgrade could result from a decision  
12 by a regulatory authority that the rating agency deems to be unfavorable. When Oncor  
13 agreed to take on this condition, its senior secured ratings were at least three notches  
14 above the trigger level, so it was not an onerous condition for Oncor. Instead, Joint  
15 Applicants have appropriately proposed to suspend dividends if EPE's credit rating  
16 falls below investment grade for EPE senior unsecured debt, except for contractual tax  
17 payments, until otherwise ordered by the Commission or EPE's credit rating returns to  
18 investment grade.

19 **Q. DO YOU HAVE ANY COMMENTS ON MR. ANTONUK'S PROPOSALS**  
20 **REGARDING DEBT IN SECTION 9?**

21 A. Yes, I do.

- 22 • Condition 9a: This condition is overly broad. There is likely to be a need for guarantees  
23 or pledges among IIF US 2 and one or more Sun Jupiter Entities. However, such  
24 guarantees among entities that are outside of the EPE ring fence would not increase  
25 bankruptcy or default risk at EPE, and no harm could come to EPE's customers as a  
26 consequence.
- 27 • Condition 9b: This condition is also framed too broadly. Lenders in credit facilities or  
28 term debt of Sun Jupiter will legitimately require that an event of default or event of  
29 bankruptcy of EPE will constitute a default in Sun Jupiter's obligation. The proper

1 condition is one that rules out any cross default in credit facilities or debt of EPE  
2 triggered by the default or event of bankruptcy of any Sun Jupiter entity or IIF US 2.

- 3 • Condition 9c: The proposed condition states that the consolidated debt of all Sun  
4 Jupiter Entities and EPE (including EPE short-term debt) will not exceed EPE's  
5 maximum debt to equity ratio as established by the Commission for ratemaking  
6 purposes. As discussed above, this is unreasonable and contrary to historical  
7 Commission practice.
- 8 • Condition 9d: This proposed condition rules out any future normal banking business  
9 between EPE and JP Morgan, JP Morgan Chase, and many other entities. JP Morgan  
10 Chase is the largest U.S. bank and a standard provider of banking services to companies  
11 in the utilities sector. JP Morgan Chase is currently a participant in EPE's bank  
12 facilities. This condition would preclude using banking or credit services from JP  
13 Morgan Chase, even if that were the lowest cost option available. This condition is not  
14 premised upon any increase in bankruptcy risk or risk of consolidation in bankruptcy.  
15 Nonetheless, to provide Staff and the Commission comfort, Joint Applicants have  
16 proposed EPE and Sun Jupiter maintain arm's-length relationships with all affiliates  
17 and all persons, entities, and interests directly or indirectly owned or controlled by JP  
18 Morgan.
- 19 • Condition 9e: This condition would be acceptable if it were framed more narrowly.  
20 Properly, EPE should not include in its debt or credit agreements any financial  
21 covenants or rating agency triggers related to IIF, IIF US 2, Sun Jupiter Entities, et al.,  
22 but there is no reason to extend this prohibition to the Sun Jupiter Entities that are  
23 outside of the ring fence. However, lenders to Sun Jupiter Holdings LLC will  
24 legitimately require some financial covenants relating to EPE or other Sun Jupiter  
25 Entities.
- 26 • Condition 9f: This condition is quite impractical and cannot be administered as written.  
27 It would require EPE to adjust its equity and debt on a daily or weekly basis and to  
28 effect instantaneous changes in the amount of debt and equity capital.
- 29 • Condition 9g: This proposed condition indicates that EPE's Board of Directors is to  
30 have the sole power and obligation to apply good faith and reasonable examination to  
31 financial ratios and take action on commitments concerning debt amounts. It seems

1           improbable that all the directors or disinterested directors will perform calculations  
2           themselves at the board meeting. This is unclear and ambiguous, and I am not sure of  
3           its significance.

- 4           • Condition 9h: This condition would restrict payment of dividends and distributions by  
5           EPE if payment thereof would lower the amount of equity below the authorized  
6           regulatory level. This is similar to an existing condition proposed by the Joint  
7           Applicants, and it would be acceptable if contractual tax payments were exempted from  
8           the block.
- 9           • Conditions 9i and 9j: These conditions would be acceptable if they relate only to EPE  
10          and Sun Jupiter Holdings LLC. Above that level in the corporate chain, there is no  
11          reason to restrict any other Sun Jupiter Entities. There would be no bankruptcy or  
12          insolvency impact upon EPE or harm to any EPE customers of shared credit facilities  
13          or intercompany loans among those more remote Sun Jupiter Entities.

14   **Q.    WHAT IS YOUR RESPONSE TO MR. ANTONUK’S PROPOSED CONDITIONS**  
15   **REGARDING SOLVENCY AND BANKRUPTCY (SECTION 10 OF**  
16   **ATTACHMENT JA-2)?**

17   A.    Some of Mr. Antonuk’s proposed conditions create ambiguity and would need to be  
18   modified.

- 19          • Condition 10a: The proposed condition 10a requiring a Non-Consolidation legal  
20          opinion is similar to a commitment proposed by the Joint Applicants though it does  
21          introduce ambiguity. For example, Mr. Antonuk’s condition states that Joint  
22          Applicants’ must obtain a “firm opinion.” It is unclear what “firm” means in this  
23          context. The Joint Applicants’ proposal eliminates ambiguity raised by Mr. Antonuk.
- 24          • Condition 10b: The intention of condition 10b appears to be reasonable at the outset  
25          (“Neither the Sun Jupiter Entities nor any other person or entity will have or be granted  
26          the power to make a voluntary bankruptcy filing”), but the language that follows it is  
27          too broad and ambiguous. To “place EPE into bankruptcy” or other bankruptcy-related  
28          actions is clear, but to “create a risk of placing EPE into bankruptcy” is ambiguous.

1 **Q. DO YOU HAVE ANY COMMENTS ON MR. ANTONUK’S CONDITIONS**  
2 **RELATED TO AFFILIATE RELATIONSHIPS AND CODE OF CONDUCT?**

3 A. Yes. This is another attempt by Mr. Antonuk to expand the regulatory regime.

- 4 • Condition 11a: This condition is an overly-broad constraint on any transfers of material  
5 assets among various affiliates, absent prior Commission consent. The Joint  
6 Applicants’ version of this condition provides a carve-out for arm’s length transfers  
7 that are consistent with the Commission’s affiliate standards. I believe that the Joint  
8 Applicants’ commitment is reasonable, provides adequate protection, and is consistent  
9 with the Commission’s standing policies and practices.
- 10 • Condition 11c: The first two sentences of Mr. Antonuk’s Condition 11c appear to be  
11 reasonable except for the language that applies the condition to “any entity with a direct  
12 or indirect ownership interest in EPE or the Sun Jupiter Entities.” This language is  
13 ambiguous and overly broad in that taken quite literally, would apply an affiliate  
14 standard to the 40 million families that have some ownership interest in IIF US 2  
15 through their investments in pension funds and other investments that have interests in  
16 IIF US 2. It is not clear what the third sentence is trying to accomplish. The  
17 Commission has rules around competitive affiliates and Joint Applicants will follow  
18 the Commission’s rules.

19 **Q. HAVE YOU ANY RESPONSE REGARDING CONDITIONS RELATING TO**  
20 **BOOKS AND RECORDS OR ANY OTHER AGREEMENTS (SECTIONS 12 AND**  
21 **13 OF ATTACHMENT JA-2)?**

22 A. Yes.

- 23 • Condition 12b: This condition is overly broad. It appears to give the Commission a  
24 license to search broadly in documents of many entities that are quite remotely related.  
25 Joint Applicants’ proposal is more than sufficient to provide the Commission access to  
26 the information it may need for an audit or review of affiliate transactions between EPE  
27 and IIF US 2 or its affiliates.
- 28 • Condition 12c: This condition has the same problems as the related 12b. Furthermore,  
29 it would deny EPE its normal right to recover its reasonable expenses including its  
30 ability to challenge discovery requests that are beyond the permissible scope of

1 discovery. It should not be included among the conditions approving the Proposed  
2 Transaction.

- 3 • Condition 13a: This condition states that the Sun Jupiter Entities and IIF US 2 will  
4 continue to hold 100% of EPE for ten years, which, as I noted before, is in conflict with  
5 the provisions of 7f that call for the Board of Directors of EPE to initiate public sale of  
6 incremental shares in EPE.
- 7 • Condition 13h: This condition states that for two years after closing, each and every  
8 EPE employee will be guaranteed the right to the same compensation. As written this  
9 would preclude any performance-related dismissals or demotions. Furthermore, some  
10 changes to EPE's compensation structure will be necessary because of the change from  
11 a publicly traded company to private ownership. Mr. Hirschi also addresses this  
12 condition in his rebuttal testimony. It should not be included among the conditions  
13 approving the Proposed Transaction.

## 14 2. Critique of Intervenors' Ring-Fencing Recommendations

15 **Q. CAN YOU PROVIDE ANY COMMENT REGARDING MR. GRIFFEY'S**  
16 **RECOMMENDATIONS REGARDING THE JOINT APPLICANTS' PROPOSED**  
17 **CONDITIONS REGARDING A DIVIDEND BLOCKER?**

18 A. Mr. Griffey recommends that the order should add a condition that no dividends or  
19 distributions will be paid if the credit rating of EPE falls below BBB, and allow the  
20 directors of EPE to halt the dividend if they believe that is in the best interest of the utility.<sup>30</sup>  
21 I consider it unreasonable and imprudent to set a rating threshold that allows no tolerance  
22 relative to the current rating level, so that even a single notch downgrade by either agency  
23 would block dividends. As I mentioned earlier, EPE could experience a one-notch  
24 downgrade due to an unfavorable decision by a regulatory authority, even though there has  
25 been no other change in the financial results or business of EPE. This is an inappropriate  
26 application of an Oncor condition to EPE. When Oncor agreed to take on the same  
27 condition, its secured ratings were at least three notches above the trigger level, so this was  
28 not a hair trigger for Oncor.

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<sup>30</sup> Griffey Direct at 27-28.

1 I believe that the condition proposed by the Joint Applicants that requires  
2 maintaining equity at the authorized equity ratio as determined by the Commission for rate  
3 setting is preferable and far more objective than a ratings trigger. The equity ratio is subject  
4 to cure, whereas the credit rating is not subject to any simple cure. Notwithstanding the  
5 foregoing, Joint Applicants have agreed to a dividend blocker if EPE's credit ratings fall  
6 below investment grade. This should provide further assurance to the Commission and  
7 interested stakeholders that no actions are taken to degrade the financial health of EPE.

8 Mr. Griffey also suggests regarding measuring whether a dividend or distribution  
9 is permissible, "Change the dividend stopper on maintaining the debt/equity ratio to capture  
10 possible IIF US 2 use of short-term debt as a substitute for long-term debt."<sup>31</sup> However,  
11 he does not explain how this calculation would be carried out. I presume that he would  
12 add the short-term debt to the capital structure authorized and then recalculate the ratio of  
13 authorized equity to total capital plus short-term debt. If this is in fact his suggestion, then  
14 it would not alter any dividend decisions versus the form of the calculation that uses only  
15 long-term debt and equity.

16 Finally, any provision that blocks dividends and distributions should exempt  
17 contractual tax payments, as proposed by the Joint Applicants.

18 **Q. DO YOU HAVE ANY OBJECTIONS TO THE CHANGES TO THE JOINT**  
19 **APPLICANTS' RING-FENCING CONDITIONS PROPOSED BY MR. LAWTON?**

20 **A.** Yes. Mr. Lawton says that the Joint Applicants' Regulatory Commitment No. 32 should  
21 require annual Commission approval or an annual filing setting forth the capital structure  
22 and the proposed EPE dividend payments.<sup>32</sup> I think it is unreasonable to require  
23 Commission approval of dividends planned or declared, but in other transactions it has  
24 been typical that whenever a dividend is determined, an officer of the utility provides a  
25 certificate saying that making the dividend or distribution payment would not violate the  
26 capitalization ratios authorized by the Commission.

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<sup>31</sup> *Id.* at 28.

<sup>32</sup> Lawton Direct at 33.

1           Also, Mr. Lawton proposes that the Joint Applicants' Regulatory Commitment No.  
2 33 should be modified to add that EPE's authorized equity ratio for ratemaking should not  
3 exceed 52%.<sup>33</sup> In my opinion, that proposal is totally inappropriate. The Commission sets  
4 the equity ratio for ratemaking purposes based on conditions in the capital markets and the  
5 economy that vary from time to time. It would not be reasonable or equitable to subject  
6 EPE to a regulatory condition that limits EPE on the one hand at no more than a 52% equity  
7 ratio but does not bind the Commission from reducing the equity component below 52%.

8 **Q. WHAT SUGGESTIONS DOES MR. DANIEL MAKE IN HIS DIRECT**  
9 **TESTIMONY REGARDING REGULATORY CONDITIONS?**

10 A. Mr. Daniel proposes that Sun Jupiter and IIF US 2 should be required to maintain EPE's  
11 capitalization policies and practices for at least 10 years after the Proposed Transaction  
12 closes. This is unnecessary and perverse. The Joint Applicants' proposed conditions  
13 require them to maintain the capital structure authorized by the Commission for  
14 ratemaking, and would curtail their dividends and distributions if the payment of a dividend  
15 would violate those ratios. The Commission may change its authorized capital structure in  
16 the future. The situation I have just described would work consistently and in harmony;  
17 another commitment that would freeze the current capital structure for EPE would not be  
18 consistent with the Commission's authorized capital structure for ratemaking purposes.

19           Mr. Daniel also urges that the Commission should approve ring-fencing provisions  
20 that are not less strict than those in the Oncor/ Sempra order. As I have already explained,  
21 the best protective mechanisms are specific to each company's individual situation. Ring-  
22 fencing can be effective while being different from the details of the Oncor/Sempra  
23 transaction. For example, the recent Commission order in the case of Sharyland adopts  
24 different protective mechanisms, while still providing adequate protections.

25 **Q. PLEASE SUMMARIZE YOUR CONCLUSIONS REGARDING THE**  
26 **WITNESSES' PROPOSED PROTECTIVE MECHANISMS.**

27 A. There is no reason that the protective mechanisms in the case of EPE should be identical  
28 to those in the Oncor/Sempra transaction, and indeed there are several important reasons

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<sup>33</sup> Id. at 33.



1 that they should be different. First, the Oncor/Sempra ring-fencing is a carryover from  
2 mechanisms that were necessary when Oncor was a subsidiary of Energy Future Holdings,  
3 a highly leveraged company that owned a leveraged competitive power generation  
4 company and a retail and wholesale energy marketer, both of which entities did business  
5 in the very same market in which Oncor operated. None of these conditions are relevant  
6 in this transaction. Second, Oncor is at least seven times as large as EPE, and Sempra is  
7 quite large also; some ring-fencing provisions that are a modest burden to Oncor and  
8 Sempra would be a massive burden to EPE and Sun Jupiter.

9 Also, more ring-fencing is not necessarily better. It is preferable to have a smaller  
10 set of protective mechanisms that are effective. It is easier for EPE, the Commission, and  
11 Commission Staff to monitor a smaller list of highly effective commitments, rather than a  
12 bloated list of conditions including redundancies.

13 The Joint Applicants' proposed regulatory commitments as enhanced and clarified  
14 will provide full and robust protection to EPE.

## 15 VII. Conclusion

### 16 Q. PLEASE SUMMARIZE YOUR REBUTTAL TESTIMONY.

17 A. I believe it is important to examine three misleading or false premises that underlie the  
18 testimony of Mr. Lawton, Mr. Griffey, Mr. Daniel, and Mr. Antonuk. The first false  
19 premise is that EPE has abundant access to capital markets and equity funding under the  
20 status quo and that EPE competes for funds as an equal in the capital markets against larger  
21 utilities. The implication of accepting this false premise is to ignore or disparage the  
22 material benefits that the Proposed Transaction can bring to EPE and its customers through  
23 expanded and easier access to capital funding.

24 The second false premise is that the investors in IIF US 2 are rapacious venture  
25 capitalists whose motivation for acquiring ownership of EPE is to strip the utility of equity  
26 and capital and promote self-dealing relationships with the utility. Or, an alternate  
27 proposition is that IIF US 2 aims to cause EPE to over-invest in costly and wasteful projects  
28 to satisfy nefarious Environmental, Social, and Governance ("ESG") goals. Neither of  
29 these suppositions is accurate. In fact, the investors in IIF US 2 are normal institutional  
30 investors, such as managers of pension funds and endowment funds, insurers, and

1 managers of estates and family funds seeking longer-term holdings in relatively low risk  
2 infrastructure situations.

3 A third misleading premise is the faulty analogy of the Proposed Transaction to the  
4 highly leveraged acquisition of TXU Corp. that formed Energy Future Holdings. For  
5 numerous reasons, Energy Future Holdings is not a reasonable analogue to the Proposed  
6 Transaction.

7 The second and third misleading premises provide the basis for proposals of overly  
8 broad and excessive regulatory conditions that are unreasonable and unwarranted. More  
9 ring-fencing does not necessarily produce better protection, and a simpler set of protective  
10 mechanisms can be effective and efficient in terms of the ongoing time and attention of  
11 EPE management, the Commission, and Staff.

12 The Joint Applicants' proposed regulatory commitments as enhanced and clarified  
13 will provide full and robust protection to EPE.

14 **Q. DOES THIS CONCLUDE YOUR DIRECT TESTIMONY?**

15 **A.** Yes, it does.

**AFFIDAVIT OF ELLEN LAPSON**

THE STATE OF FLORIDA

COUNTY OF Orange

)  
)  
)

This day, Ellen Lapson, the affiant, appeared in person before me, a notary public, who knows the affiant to be the person whose signature appears below. The affiant stated under oath:

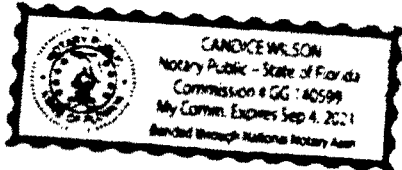
My name is Ellen Lapson. I am of legal age and a resident of the State of New York. The foregoing testimony offered by me is true and correct, and the opinions stated therein are, to the best of my knowledge and belief, accurate, true and correct.

Ellen Lapson  
Ellen Lapson, CFA

SUBSCRIBED AND SWORN TO BEFORE ME, notary public, on this the 11<sup>th</sup> day of November, 2019.

Candice Wilson  
Notary Public, State of Florida

My Commission expires:  
9/04/21



# MOODY'S

## INVESTORS SERVICE

### Rating Action: Moody's downgrades El Paso Electric to Baa2, outlook stable

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17 Sep 2019

#### Approximately \$1.2 billion of debt securities affected

New York, September 17, 2019 -- Moody's Investors Service ("Moody's") downgraded El Paso Electric Company's (EE) Issuer and senior unsecured ratings to Baa2 from Baa1. The outlook for EE is stable. This concludes the review for downgrade that was initiated on 1 July 2019.

#### Downgrades:

..Issuer: El Paso Electric Company

....Issuer Rating, Downgraded to Baa2 from Baa1

....Senior Unsecured Regular Bond/Debenture, Downgraded to Baa2 from Baa1

..Issuer: Maricopa (County of) AZ, Poll. Ctrl. Corp.

....Senior Unsecured Revenue Bonds, Downgraded to Baa2 from Baa1

#### Outlook Actions:

..Issuer: El Paso Electric Company

....Outlook, Changed To Stable From Rating Under Review

#### RATINGS RATIONALE

"We expect El Paso Electric's credit metrics to be sustained at lower levels going forward, with a ratio of cash flow from operations before working capital changes (CFO pre-WC) to debt of around 16%, more in line with slightly lower rated vertically integrated utility peers" stated Nana Hamilton, Assistant Vice President. The lower metrics are primarily driven by a combination of high, partly debt-funded capital expenditures and cash flow pressure from tax reform. Moody's assessment of EE also considers the pending acquisition of the company by the Infrastructure Investments Fund (IIF, not rated). We understand that the transaction will be primarily funded with equity from IIF, with no acquisition debt at the EE level, which supports the stable rating outlook on the utility.

Over the next few years, EE projects increasing capital expenditures, with capital spending returning to close to \$300 million per year, as was the case during the company's last peak spending period in 2014-2015. Higher debt incurred to help fund this increase in capex, together with a negative impact to cash flows from the loss of bonus depreciation, will result in lower projected financial metrics. Moody's expects a CFO pre-WC/debt ratio sustained around 16%, down from 18% in 2017 and 2018. This level is more commensurate with a mid-Baa rating when compared with similarly rated peers and the financial ratio ranges specified in Moody's Regulated Electric and Gas Utilities methodology.

On 3 June 2019, EE announced that it had entered into an agreement to be acquired by IIF, an investment vehicle advised by J.P. Morgan Investment Management Inc., for approximately \$4.3 billion, including \$1.5 billion of EE net debt. The equity interests in EE will be held by an indirect special purpose entity, Sun Jupiter Holdings, LLC, wholly owned by IIF. IIF intends to fund the acquisition equity value with a \$2.3 billion equity contribution and a \$625 million term loan at Sun Jupiter. Moody's current credit assessment and the stable rating outlook on EE assumes that there will be no acquisition debt placed at EE. The assessment also takes into account 1) IIF's commitment to hold EE for at least 10 years 2) proposed ring fencing commitments that will separate EE's operational and financial activities from those of IIF and its other affiliates and 3) commitments to preserve the regulatory capital structure at the utility.

The transaction is expected to close in the first half of 2020, and is pending regulatory approvals from various parties including the Public Utility Commission of Texas (PUCT), the New Mexico Public Regulation

Commission (NMPRC) and the Federal Energy Regulatory Commission (FERC). Moody's would view any changes in the proposed financial policies or ring fencing provisions that adversely affect EE's financial stability as credit negative.

#### Outlook

The stable rating outlook reflects Moody's expectation that the pending acquisition by IIF will not materially affect the credit quality of EE. The stable outlook also incorporates our view that EE will continue to experience above average customer and load growth and maintain constructive regulatory relationships with the PUCT, the NMPRC and the El Paso City Council.

#### What could change the rating -- Up

EE's ratings could be upgraded if financial metrics improve such that its CFO pre-W/C to debt ratio is sustained above 19%.

#### What could change the rating -- Down

EE's ratings could be downgraded if the utility's ratio of CFO pre-W/C to debt declines below 15%. A downgrade could be considered if a more contentious political or regulatory environment emerges in Texas or New Mexico, or if political intervention at the El Paso City Council creates uncertainty over cost or investment recovery. In addition, if EE's dividend payout increases meaningfully to support additional debt at entities above it following its acquisition by IIF, or if the acquisition is otherwise detrimental to the credit quality of EE, ratings could be downgraded.

The principal methodology used in these ratings was Regulated Electric and Gas Utilities published in June 2017. Please see the Rating Methodologies page on [www.moodys.com](http://www.moodys.com) for a copy of this methodology.

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## CREDIT OPINION

20 September 2019

Update

✓ Rate this Research

### RATINGS

#### El Paso Electric Company

Domicile	El Paso, Texas, United States
Long Term Rating	Baa2
Type	LT Issuer Rating
Outlook	Stable

Please see the [ratings section](#) at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.

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## El Paso Electric Company

Update following downgrade to Baa2

### Summary

El Paso Electric Company's (EE) credit profile reflects its regulated utility operations predominantly in the constructive regulatory environment of Texas where the company derives approximately 80% of its non-fuel base revenues. The remaining 20% of its revenues is generated in New Mexico, where the regulatory environment is less constructive. EE's rates and services are regulated by the Public Utility Commission of Texas (PUCT), the New Mexico Public Regulation Commission (NMPRC), the Federal Energy Regulatory Commission (FERC) and incorporated municipalities in its Texas service territory. Base rate decisions made by municipalities are ultimately subject to review and approval by the PUCT. EE's regulatory process in Texas has at times been impeded by political intervention by the El Paso City Council. We expect that EE will continue to manage its relationship with the El Paso City Council and its state regulators such that political intervention is limited and regulatory lag or recovery of prudent costs and investments continues to improve through rate case proceedings. EE's credit is constrained by its relatively small size and market concentration.

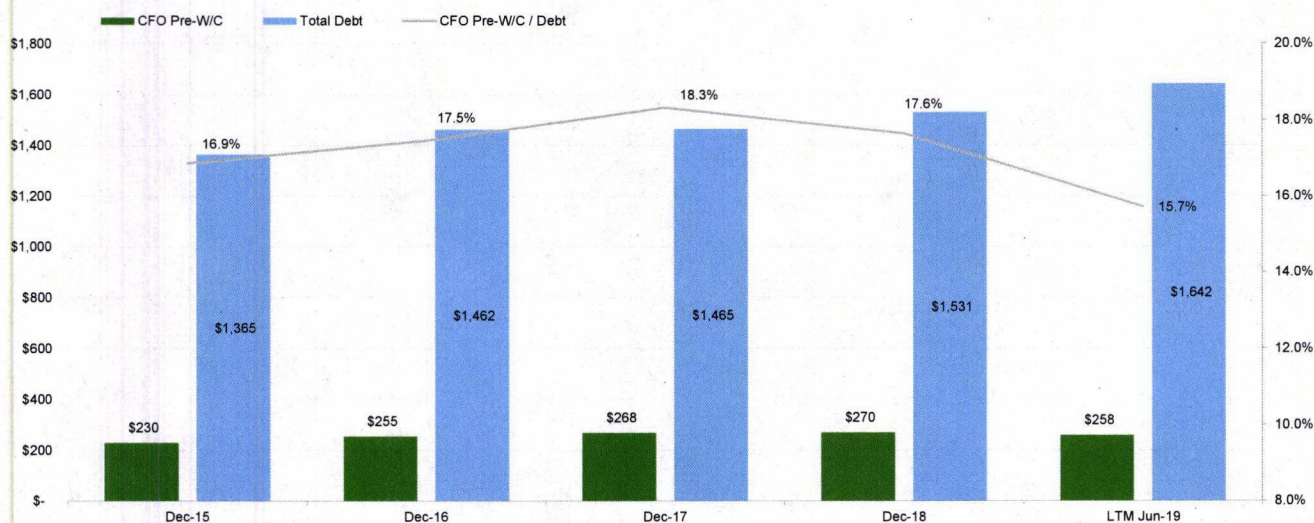
Over the next few years, we see lower financial metrics at EE, driven by the loss of bonus depreciation, increasing debt to fund higher capital expenditures and a dividend that continues to grow at around 8% annually. We project the utility's cash flow from operations pre-working capital changes (CFO pre-W/C) to debt ratio in the 15-17% range and its ratio of CFO pre-W/C – Dividends or Retained Cash Flow (RCF) to debt in the 11-13% range, down from a 2017-2018 average of about 18% and 14.5% respectively.

### Recent Developments

On 3 June 2019, EE announced that it had entered into an agreement to be acquired by the Infrastructure Investments Fund (IIF, not rated), an investment vehicle advised by J.P. Morgan Investment Management Inc. IIF will pay \$68.25 in cash per share, representing an enterprise value of approximately \$4.3 billion, including \$1.5 billion of EE net debt. We calculate an acquisition multiple of about 1.8x EE's rate base, a trailing twelve months P/E multiple of roughly 28.5x, and about 12.5x trailing twelve months EBITDA.

The equity interests in EE will be held by an indirect special purpose entity, Sun Jupiter Holdings, LLC, wholly owned by IIF. IIF intends to fund the acquisition equity value with a \$2.3 billion equity contribution and a \$625 million term loan at Sun Jupiter. Sun Jupiter will also have a \$75 million senior secured revolving credit facility. Moody's current credit assessment and stable rating outlook on EE assumes that there will be no acquisition debt placed at EE. The assessment also takes into account 1) IIF's commitment to hold EE for at least 10 years 2) proposed ring fencing commitments that separate EE's operational and financial activities from those of IIF and its other affiliates and 3) commitments to preserve the regulatory capital structure at the utility. The transaction is expected to close in the first half of 2020, and is pending regulatory approvals from various parties including the PUCT, FERC and NMPRC. Moody's would view any changes in the proposed financial policies or ring fencing provisions that adversely affect EE's financial stability as credit negative.

Exhibit 1

**Historical CFO Pre-WC, Total Debt and CFO Pre-WC to Debt (\$ MM)**

Source: Moody's Financial Metrics

**Credit Strengths**

- » Constructive regulatory environment in Texas
- » Solid customer and load growth driving rate base growth
- » Well positioned to meet future environmental requirements

**Credit Challenges**

- » Small size and scale
- » Heightened capital expenditure program will lead to a decline in financial metrics
- » Less supportive regulatory environment in New Mexico relative to other jurisdictions

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the ratings tab on the issuer/entity page on [www.moody.com](http://www.moody.com) for the most updated credit rating action information and rating history.

## Rating Outlook

The stable rating outlook reflects Moody's expectation that the pending acquisition by IIF will not materially affect the credit quality of EE. The stable outlook also incorporates our view that EE will continue to experience above average customer and load growth and maintain constructive regulatory relationships with the PUCT, the NMPRC and the El Paso City Council

## Factors that Could Lead to an Upgrade

EE's ratings could be upgraded if financial metrics improve such that its CFO pre-W/C to debt ratio is sustained above 19%.

## Factors that Could Lead to a Downgrade

EE's ratings could be downgraded if the utility's ratio of CFO pre-W/C to debt declines below 15%. A downgrade could be considered if a more contentious political or regulatory environment emerges in Texas or New Mexico, or if political intervention at the El Paso City Council creates uncertainty over cost or investment recovery. In addition, if EE's dividend payout increases meaningfully to support additional debt at entities above it following its acquisition by IIF, or if the acquisition is otherwise detrimental to the credit quality of EE, ratings could be downgraded.

## Key Indicators

Exhibit 2

### El Paso Electric Company [1]

	Dec-15	Dec-16	Dec-17	Dec-18	LTM Jun-19
CFO Pre-W/C + Interest / Interest	4.3x	4.4x	3.8x	3.8x	3.6x
CFO Pre-W/C / Debt	16.9%	17.5%	18.3%	17.6%	15.7%
CFO Pre-W/C – Dividends / Debt	13.4%	14.1%	14.7%	13.9%	12.1%
Debt / Capitalization	47.6%	47.5%	50.4%	50.8%	52.4%

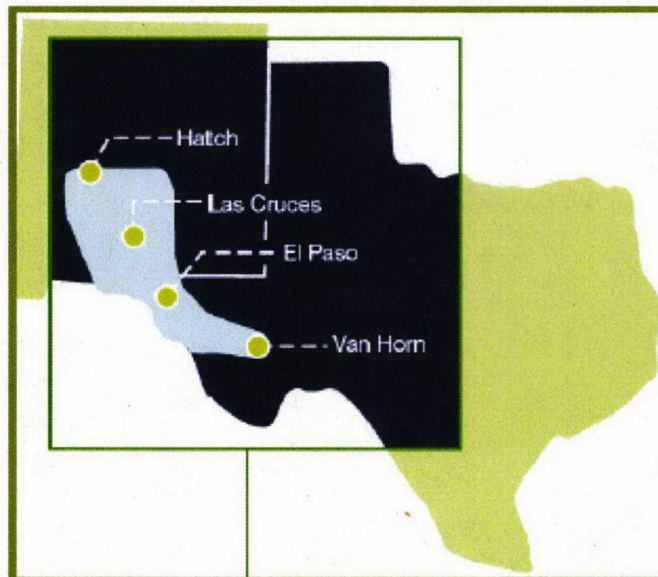
[1] All ratios are based on 'Adjusted' financial data and incorporate Moody's Global Standard Adjustments for Non-Financial Corporations.

Source: Moody's Financial Metrics

## Profile

El Paso Electric Company is a vertically integrated regulated utility that provides electric service to approximately 428,000 retail customers in a 10,000 square mile area in the Rio Grande valley in west Texas and southern New Mexico with concentrations in the cities of El Paso, TX and Las Cruces, NM. Texas accounts for about 80% of revenues. At year-end 2018, EE had generating capacity of 2,085 MW, consisting of approximately 70% natural gas, 30% nuclear and less than 1% solar. EE is primarily regulated by the Public Utility Commission of Texas and the New Mexico Public Regulation Commission.

Exhibit 3

**El Paso Electric's Service Territory**

Source: Company Presentations

**Detailed Credit Considerations****CREDIT SUPPORTIVE REGULATORY ENVIRONMENT IN TEXAS**

Given that approximately 80% of EE's revenues are generated in Texas, we attribute more weight to the credit supportiveness of the PUCT relative to the NMPRC, and the Texas regulatory framework is fundamentally credit supportive. However, with generation investments historically recoverable only through a general rate case, EE has experienced regulatory lag particularly during periods of high generation spending as in 2014-2015. In a positive development, House Bill 1397, passed on 14 June 2019, requires the PUCT to adopt, no later than September 2020, rules under which Texas utilities outside of the Electric Reliability Council of Texas (ERCOT) would recover generation investments through a rider. The bill would allow EE to file an application with the PUCT to recover its investment in a power generation facility before the facility is placed in service. If approved by the commission, EE would start recovering its investment beginning the day the facility is placed in service. Amounts recovered through the rider would then be subject to reconciliation in EE's first general rate case following the approval of the rider. The PUCT would, during the reconciliation, determine if recovered amounts are reasonable and necessary. We believe the new generation rider will help alleviate regulatory lag at EE beyond 2020.

As part of EE's rate case settlement in 2017, a baseline revenue requirement was established for Transmission and Distribution Cost Recovery Factors, which allows EE to recover incremental transmission and distribution costs periodically outside of a general rate, a credit positive. This also helps mitigate regulatory lag and allows EE to recover associated costs without the need to wait for its next general rate case. In January 2019, EE filed a Transmission Cost Recovery Factor (TCRF) to recover a requested \$8.1 million of Texas transmission revenues for transmission-related investments placed in service from 1 October 2016 through 30 September 2018, since these costs are not a part of EE's base rate. Similarly, EE filed its Distribution Cost Recovery Factor (DCRF) in March 2019, seeking recovery of approximately \$7.9 million of distribution-related costs incurred from 1 October 2016 through 31 December 2018. The company has reached settlement agreements in principle with key parties in the proceedings. The settlement agreements have been filed with the PUCT and are pending approval.

We note that there is a risk of political intervention by the incorporated municipalities in Texas, primarily the El Paso City Council, which can weigh on EE's credit if it leads to insufficient recovery of prudently incurred costs and investments or significant regulatory lag, both credit negatives. For now, we do not incorporate a view that a contentious political or regulatory environment is likely.

In both Texas and New Mexico, EE is able to recover its costs for fuel and purchased power via rate adjustment mechanisms which reduce the time for recovery of these costs, a credit positive. EE's fuel rates can be adjusted three times per year to reflect changes in current and projected fuel and purchased power costs and EE can recover/refund deferred balances, generally over the following twelve months. Fuel cost recovery in Texas requires that the company request to refund over-collections in any month they become significant (in excess of 4% of the previous twelve months costs) and request a surcharge when under-collections become just as material. Volatility in fuel prices can result in frequent adjustments to EE's fuel factors and fairly significant swings in its fuel deferral balances. In both Texas and New Mexico, recoveries made under these mechanisms are subject to periodic review by the state regulatory body and subject to potential refund. At 30 June 2019, EE had a net fuel over-recovery of \$21.7 million, including over-recoveries of \$20.3 million in Texas, \$1.3 million in New Mexico and approximately \$0.1 million in EE's FERC jurisdiction. The over-recoveries are refunded through EE's fuel adjustment clauses during the year.

### LESS SUPPORTIVE REGULATORY ENVIRONMENT IN NEW MEXICO

The NMPRC regulatory framework has historically been less predictable and transparent than those of most other US jurisdictions. New Mexico allows certain practices that mitigate regulatory lag, such as the use of rate adjustment mechanisms and a forecasted test year in rate cases. However, it has taken issue on a number of occasions with cases using future test years, such as Southwestern Public Service Company's (SPS: Baa2 stable) rate case that was rejected in April 2017. EE continues to file its New Mexico rate cases using a historic test year, which considering that EE's New Mexico rate cases can take over a year to be finalized, exacerbates regulatory lag. This regulatory lag is sometimes offset by growth. While we view the New Mexico regulatory environment as more challenging than most US jurisdictions, only about 20% of EE's revenues comes from its New Mexico services.

EE's most recent rate case in New Mexico was finalized on 8 June 2016, when the NMPRC issued a final order approving an annual revenue increase of \$11 million, an allowed ROE of 9.48% and an equity ratio of 49.29%. EE's original request was for a non-fuel base rate increase of \$8.6 million based on an authorized ROE of 9.95% with an equity ratio of 49.29% based on a rate case test year-end of 2014. EE was required by the NMPRC to file its next New Mexico rate case by 31 July 2019. However, on 10 July 2019, NMPRC approved a joint request by various parties including EE to delay filing for the mandated rate case until after the merger proceedings.

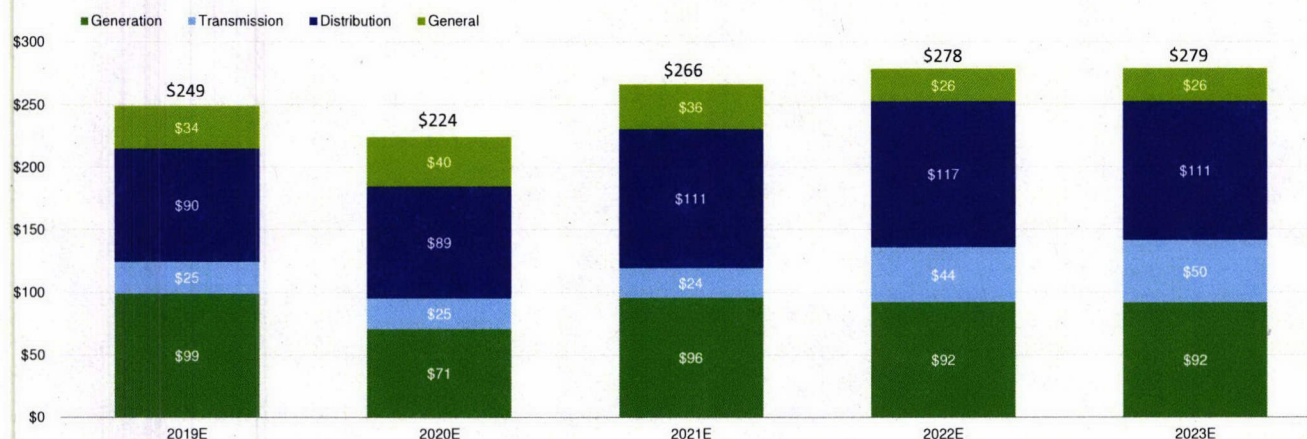
### SOLID CUSTOMER GROWTH DRIVING RATE BASE GROWTH

EE has seen good customer and load growth historically, which is atypical for the utility sector. From 2008-2018, EE experienced a 10-year compound annual growth rate (CAGR) of 1.57% in average number of residential customers. The increase in residential growth and customer demand in EE's service territory has been primarily driven by population increases and infrastructure investment associated with the US military's base realignment program at Fort Bliss in Texas, the construction of Union Pacific (UP) intermodal rail and the increase in cross-border trade between El Paso and Mexico. EE also benefits from sizable economic growth from the expansion of other sectors including industrial, medical and financial services. We expect the solid customer growth and demand usage to continue over the next few years given the economic growth in the region.

EE plans to invest about \$1.3 billion (excluding nuclear fuel costs) in capital additions over the 2019 through 2023 period to support continued customer and load growth. The expected capex investments are expected to be highest in the 2021-2023 time frame driven by the need for additional generation resources. In 2018, EE announced the winning bids for the request for proposal (RFP) process that it initiated in June 2017, which includes the construction of a 226 MW natural gas combustion turbine unit at Newman (anticipated in-service date of 2023), power purchase agreements for 200 MW of solar, and 100 MW of battery storage.

Exhibit 4

### Five Year Forecasted Capital Expenditure Plan (\$ in millions)



(1) Includes the construction of a 226 MW natural gas combustion turbine at Newman, with an expected cost of \$143 million

(2) Excludes PPAs for 200 MW of utility scale solar and 100 MW of battery storage

Source: Company Presentation

### FINANCIAL METRICS EXPECTED TO WEAKEN

Following a decline in financial metrics, with its ratio of CFO pre-WC to debt falling from around 23% in 2013 to 19% in 2014 and then to 17% in 2015, EE's financial metrics exhibited some stability, with CFO pre-WC to debt around 18% from 2016 to 2018. This stability was driven by a tempering in capital spending levels together regulatory relief for significant capital expenditures to support above industry average customer growth.

Going forward, we see the utility's estimated capital expenditures again increasing, returning to the close to \$300 million per year seen during the company's peak spending period in 2014-2015. Higher debt to help fund this increase in capex together with a negative impact to cash flows from the loss of bonus depreciation will result in lower projected financial metrics, including CFO pre-WC/debt sustained in the 15-17% range.

### SMALL SIZE AND SCALE CONSTRAIN THE CREDIT PROFILE

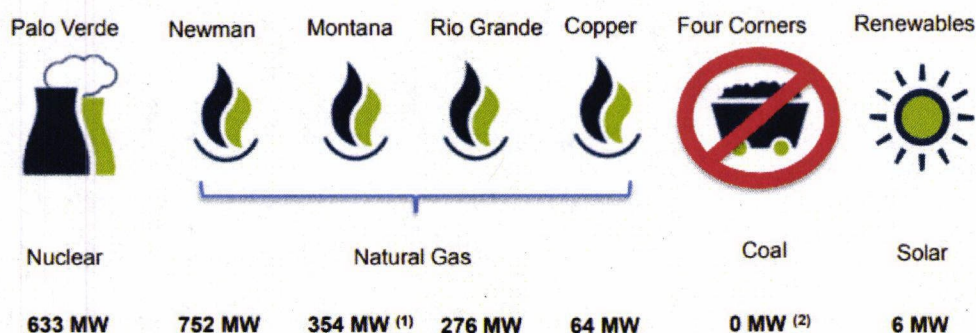
EE's credit profile also factors in its relatively small size and scale as well as market concentration as it serves about 428,000 customers in a small area of Texas and New Mexico. Texas accounts for 80% of total non-fuel revenues, the majority of which are generated in the City of El Paso, while New Mexico accounts for about 20% of total revenues. Although EE's service area is concentrated, we acknowledge that customer and load growth is expected to continue to surpass national averages.

### WELL POSITIONED TO MEET FUTURE ENVIRONMENTAL REQUIREMENTS

At year-end 2018, EE's generation portfolio consisted of approximately 70% natural gas fired generation, 30% nuclear generation and less than 1% solar. The utility's generation supply in 2018 consisted of approximately 44% natural gas, 44% nuclear, 12% purchased power and less than 1% solar.

Exhibit 5

## 2018 El Paso Electric Company's Owned Generation Mix



(1) Montana Power Station ("MPS") includes Units 1 & 2 (88 MW per unit), Units 3 & 4 (89 MW per unit).

(2) In July 2016, EE became coal free following the sale of its 7% minority ownership interest in Four Corners Units 4 & 5 and common facilities

(3) Solar purchased power represented approximately 70% of their capacity during the summer peak period

Source: Company Presentation

EE launched a 3 MW community solar program in Texas during the second quarter of 2017, and added an additional 5 MW of dedicated solar on the Holloman Air Force Base in October 2018. The company received PUCT approval in May 2019 to expand the Texas Community Solar Facility by 2MW.

With its focus on increasing renewable generation, EE is expected to comply with the renewable mandates imposed by both Texas and New Mexico. The utility is required under Texas law to obtain 5% of its total generation from renewable resources. In New Mexico, the Energy Transition Act, passed in March 2019, sets a statewide renewable energy standard of 50% clean energy by 2030 for investor-owned utilities and rural electric cooperatives and a goal of 80% by 2040, in addition to setting zero-carbon resources standards for investor-owned utilities by 2045. We believe EE is well positioned to meet these requirements through power purchase agreements, and by expanding its own renewable energy portfolio.

### Liquidity Analysis

EE has an adequate liquidity profile given its stable cash flow and good external availability. For the last twelve months (LTM) ended 30 June 2019, EE generated cash from operations of \$269 million which largely covered its \$245 million of capital expenditures (including capitalized interest during construction but excluding nuclear fuel additions) and \$60 million of shareholder dividends. Nuclear fuel addition costs (\$36 million as of LTM June 2019), which are typically funded through fixed rate senior note issuances and borrowings on EE's revolving credit facility, are recovered from customers through EE's fuel recovery mechanism as the fuel is consumed.

EE has a \$350 million revolving credit facility which expires in September 2023. The revolver includes an option to increase the size by an additional \$50 million with lender approval and an option to exercise a one-year renewal option up to two times. The facility is available for direct borrowings by a trust that is used to finance EE's nuclear fuel inventory purchases and for general corporate purposes, including the issuance of letters of credit. At 30 June 2019, EE had \$189.1 million of availability on its revolver. There is no material adverse change (MAC) clause that could limit incremental borrowings. At 30 June 2019, EE's debt to capital ratio of 57% was in compliance with its only financial covenant, a maximum debt to capital ratio of 65%.

EE has \$45 million of Rio Grande Resources Trust II bonds due in August 2020 and \$150 million of senior notes maturing in December 2022.

## Rating Methodology and Scorecard Factors

Exhibit 6

### Rating Factors

El Paso Electric Company

	Current LTM 6/30/2019		Moody's 12-18 Month Forward View As of Date Published [3]	
Regulated Electric and Gas Utilities Industry Grid [1][2]				
<b>Factor 1 : Regulatory Framework (25%)</b>	<b>Measure</b>	<b>Score</b>	<b>Measure</b>	<b>Score</b>
a) Legislative and Judicial Underpinnings of the Regulatory Framework	A	A	A	A
b) Consistency and Predictability of Regulation	Baa	Baa	Baa	Baa
<b>Factor 2 : Ability to Recover Costs and Earn Returns (25%)</b>				
a) Timeliness of Recovery of Operating and Capital Costs	Baa	Baa	A	A
b) Sufficiency of Rates and Returns	A	A	Baa	Baa
<b>Factor 3 : Diversification (10%)</b>				
a) Market Position	Ba	Ba	Ba	Ba
b) Generation and Fuel Diversity	A	A	A	A
<b>Factor 4 : Financial Strength (40%)</b>				
a) CFO pre-WC + Interest / Interest (3 Year Avg)	3.8x	Baa	3.3x - 3.8x	Baa
b) CFO pre-WC / Debt (3 Year Avg)	16.8%	Baa	15% - 17%	Baa
c) CFO pre-WC – Dividends / Debt (3 Year Avg)	13.3%	Baa	11% - 13%	Baa
d) Debt / Capitalization (3 Year Avg)	51.0%	Baa	46% - 51%	Baa
<b>Rating:</b>				
Scorecard-Indicated Outcome Before Notching Adjustment		Baa1		Baa1
HoldCo Structural Subordination Notching	0	0	0	0
a) Scorecard-Indicated Outcome from Grid		Baa1		Baa1
b) Actual Rating Assigned		Baa2		Baa2

[1] All ratios are based on 'Adjusted' financial data and incorporate Moody's Global Standard Adjustments for Non-Financial Corporations.

[2] As of 6/30/2019 (LTM)

[3] This represents Moody's forward view; not the view of the issuer; and unless noted in the text, does not incorporate significant acquisitions and divestitures.

Source: Moody's Financial Metrics



## Appendix

Exhibit 7

### Cash Flow and Credit Metrics [1]

CF Metrics	Dec-15	Dec-16	Dec-17	Dec-18	LTM Jun-19
As Adjusted					
EBITDA	309	341	367	328	345
FFO	231	270	280	271	260
- Div	47	50	53	58	60
RCF	184	221	226	213	201
FFO	231	270	280	271	260
+/- ΔWC	8	(31)	16	8	2
+/- Other	(1)	(15)	(11)	(0)	(2)
CFO	239	224	284	278	261
- Div	47	50	53	58	60
- Capex	325	269	240	280	273
FCF	(134)	(95)	(10)	(60)	(72)
Debt / EBITDA	4.4x	4.3x	4.0x	4.7x	4.8x
EBITDA / Interest	4.4x	4.5x	3.9x	3.4x	3.5x
FFO / Debt	16.9%	18.5%	19.1%	17.7%	15.8%
RCF / Debt	13.5%	15.1%	15.4%	13.9%	12.2%
Revenue	850	887	917	904	869
Cost of Good Sold	240	234	244	228	203
Interest Expense	71	76	95	97	99
Net Income	62	87	90	50	60
Total Assets	3,196	3,373	3,486	3,626	3,757
Total Liabilities	2,188	2,305	2,349	2,469	2,595
Total Equity	1,008	1,068	1,137	1,157	1,162

[1] All figures and ratios are calculated using Moody's estimates and standard adjustments. Periods are Financial Year-End unless indicated. LTM = Last Twelve Months.

Source: Moody's Financial Metrics

Exhibit 8

### Peer Comparison Table [1]

(in US millions)	El Paso Electric Company			Entergy Texas, Inc.			Public Service Company of New Mexico			Texas-New Mexico Power Company			Southwestern Public Service Company		
	Baa2 Stable			Baa3 Positive			Baa2 Stable			A3 Stable			Baa2 Stable		
	FYE Dec-17	FYE Dec-18	LTM Jun-19	FYE Dec-17	FYE Dec-18	LTM Jun-19	FYE Dec-17	FYE Dec-18	LTM Jun-19	FYE Dec-17	FYE Dec-18	LTM Jun-19	FYE Dec-17	FYE Dec-18	LTM Jun-19
Revenue	917	904	869	1,545	1,606	1,558	1,104	1,092	1,099	341	345	348	1,918	1,933	1,869
EBITDA	367	328	345	409	479	444	499	428	427	166	173	168	513	546	584
CFD Pre-W/C / Debt	18.3%	17.6%	15.7%	17.3%	20.9%	17.8%	19.4%	18.5%	17.3%	22.0%	17.6%	15.2%	22.6%	18.6%	17.4%
CFD Pre-W/C - Dividends / Debt	14.7%	13.9%	12.1%	17.3%	20.9%	17.8%	16.2%	14.5%	13.4%	13.2%	10.8%	8.6%	17.2%	13.0%	9.3%
Debt / EBITDA	4.0x	4.7x	4.8x	4.1x	3.5x	4.4x	3.8x	4.5x	4.6x	3.0x	3.6x	4.2x	3.9x	4.3x	4.4x
Debt / Capitalization	50.4%	50.8%	52.4%	48.2%	45.8%	49.0%	49.7%	49.6%	50.8%	39.6%	43.2%	46.4%	42.7%	42.8%	42.4%
EBITDA / Interest Expense	3.9x	3.4x	3.5x	4.8x	5.3x	5.2x	5.1x	4.6x	4.9x	5.4x	5.2x	5.1x	5.6x	6.0x	6.2x

[1] All figures & ratios calculated using Moody's estimates & standard adjustments. FYE = Financial Year-End. LTM = Last Twelve Months. RUR\* = Ratings under Review, where UPG = for upgrade and DNG = for downgrade.

Source: Moody's Financial Metrics

## Ratings

Exhibit 9

Category	Moody's Rating
<b>EL PASO ELECTRIC COMPANY</b>	
Outlook	Stable
Issuer Rating	Baa2
Senior Unsecured	Baa2

Source: Moody's Investors Service

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**MOODY'S**  
**INVESTORS SERVICE****Announcement of Periodic Review: Moody's announces completion of a periodic review of ratings of El Paso Electric Company**

01 Nov 2019

New York, November 01, 2019 -- Moody's Investors Service ("Moody's") has completed a periodic review of the ratings of El Paso Electric Company and other ratings that are associated with the same analytical unit. The review was conducted through a portfolio review in which Moody's reassessed the appropriateness of the ratings in the context of the relevant principal methodology(ies), recent developments, and a comparison of the financial and operating profile to similarly rated peers. The review did not involve a rating committee. Since 1 January 2019, Moody's practice has been to issue a press release following each periodic review to announce its completion.

This publication does not announce a credit rating action and is not an indication of whether or not a credit rating action is likely in the near future. Credit ratings and outlook/review status cannot be changed in a portfolio review and hence are not impacted by this announcement. For any credit ratings referenced in this publication, please see the ratings tab on the issuer/entity page on [www.moody's.com](http://www.moody's.com) for the most updated credit rating action information and rating history.

Key rating considerations are summarized below.

El Paso Electric Company's (EE) Baa2 rating reflects its regulated utility operations predominantly in the credit supportive regulatory environment of Texas where the company derives approximately 80% of its non-fuel base revenues. The remaining 20% of its revenues is generated in New Mexico, where we view the regulatory environment as less supportive due to sometimes inconsistent and unpredictable regulatory outcomes. The rating acknowledges above average growth in the EE's service territory, although EE's credit is constrained by its relatively small size and market concentration. We expect the utility's cash flow from operations pre-working capital to debt ratio to be in the 15-17% range.

This document summarizes Moody's view as of the publication date and will not be updated until the next periodic review announcement, which will incorporate material changes in credit circumstances (if any) during the intervening period.

The principal methodology used for this review was Regulated Electric and Gas Utilities published in June 2017. Please see the Rating Methodologies page on [www.moody's.com](http://www.moody's.com) for a copy of this methodology.

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the ratings tab on the issuer/entity page on [www.moody's.com](http://www.moody's.com) for the most updated credit rating action information and rating history.

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