Real estate investment trust structure (REIT)

Pros

Potential for lower customer rates due to reduction in income taxes on equity financing

Structure is well tested from a tax perspective for assets within specialized sectors of the real estate market (office space, residential units, healthcare facilities, railroad trackage, etc.)

Cons

Splits existing utility into two separate companies: an operating company and an asset ownership company;

Potentially creates costs to transfer operating permits to new entities;

Divides management fiduciary responsibilities between existing and new owner classes;

Distracts management and regulators from attention to improving utility operations, particularly system safety and reliability;

Structure has no consistent track record of sustaining energy utility infrastructure investment on a large-scale.

Equity risk to be retained by operating company requires equity financing and equity returns to sustain business, substantially reducing potential tax;

Without a mechanism to transfer utility operations risk to REIT equity investors, equity investment would be with the operating company, not the REIT, thereby substantially reducing any tax benefit

REIT can elect to not renew operating lease with incumbent utility; alternate lessee may be have different risk profile

REIT may be more inclined to use bankruptcy to resolve political/regulatory issues

Master limited partnership (MLP)

Pros:

Hypothetically reduces double taxation of Corporation level an investor level income taxes, potentially reducing cost of equity for selected assets;

Structure extensively tested for resource extraction industries including gas pipelines, processing, production, and gathering systems;

Structure works best for assets with accelerated depreciation to be passed through to shareholders

Cons:

Not all asset classes are eligible for the structure (traditionally used for pipelines and extractive industry assets)

Structure may not even exist after 2012 tax reform changes to be proposed by White House and Department of the Treasury;

Potentially creates costs to transfer operating permits to new entity;

Divides management fiduciary responsibilities between existing and new owner classes; distracts management and regulators from attention to improving utility operations;

Empirical data does not support the hypothesis the cost of equity declines under MLP structure compared to traditional utility financing;

Utility securitization bond financing

Pros:

Commission and all major California utilities have direct experience with the structure

Reduces return *on* capital for selected assets, without significant adverse credit rating impact, by substituting all debt financing in combination of traditional equity and debt financing;

Reduces asset recovery risk by binding state to support local of assets and revenue recovery;

Works best for assets facing high uncertainty over regulatory treatment for cost recovery

Cons:

Cannot be used to indefinitely finance utility growth and infrastructure investment without adverse risk impacts for other investors;

Requires faster recovery of capital investment to retire bond obligations, potentially offsetting carrying cost savings or even increasing revenue requirements and rates;

Requires state legislation or court order to implement;