White Paper Highlights

- Basic Franchise Fee Agreement Provisions
  - Fee
  - Term
  - Exclusive or not
  - Property Tax
  - Reimbursement of any separation costs

- Strategic Considerations
  - Relationship between Electric, Water, Wastewater and Telecom systems
    - Revenue Pledge
    - Inter-utility loans
    - Telecom services provide to LUS and LCG
  - Re-purchase of utility assets
    - Right to re-acquire
    - Pricing methodology (net book value)
  - Other
    - Power supply
    - AMI
    - Data access

- Employee Matters
  - Retention
  - Compensation
  - Severance
  - Unfunded liabilities (pension, health care, etc.)

- Business Locations and Practices
  - Local presence
  - Customer service

- Rights of way specifics
  - Underground crossings
  - Street cuttings
  - Licensing requirements
  - Relocations
  - Street lighting

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Analyses, Takeaways, Benefits, and Costs

Table 1
Cash Flows to LCG
Current Situation ($000)

Item	Avg. Annual 2017 – 2027 (1)	NPV (2)
ILOT		
Electric	$18,675	$1,458,929
Water	2,598	214,673
Wastewater	4,289	350,815
Telecom	0	0
Total ILOT	*$25,562*	*$2,024,417*
Franchise Fee		
Electric	$0	$0
Water	0	0
Wastewater	0	0
Telecom (3)	398	35,725
Total Franchise Fee	*$398*	*$35,725*
Ad Valorem Tax		
Electric	$0	$0
Water	0	0
Wastewater	0	0
Telecom	817	60,337
Total Ad Valorem Tax	*$817*	*$60,337*
Total Cash Flow to LCG		
Electric	$18,675	**$1,458,929**
Water	2,598	214,673
Wastewater	4,289	350,815
Telecom	1,215	**96,062**
Total Cash Flow to LCG	*$26,777*	*$2,120,479*

Notes:
(1) Cash Flow projection based on LUS financial proforma's developed for the 2016 CER with certain current updates.
(2) NPV of perpetuity with 3.2% discount rate and 2.1 % growth rate. NPV represents lump sum investment that generates desired cash flow.
(3) Franchise Fee assumes approximately 3% of CATV Gross Receipts.

Key Takeaway:

- Of $2.1 Billion in value, electric ILOT & telecom imputed tax payments are worth about $1.55 Billion to LCG.
- Compared to the current situation, an asset sale with combined value (cash, franchise fee, ad valorem tax) greater than or equal to $1.55 Billion after transaction costs, would have similar value to LCG.
- Transaction costs include retirement of outstanding debt, stranded investment, higher utility rates, severance costs plus other qualitative costs less benefits of selling the electric and telecom systems (Systems).
- Qualitative **costs** of selling the Systems are primarily related to the loss of local control.
  - Rates
  - Responsiveness
  - Reliability
  - Optionality
- Qualitative **benefits** of selling the Systems include:
  - Typical business risks of running the Systems
  - Employee and public safety liability
  - Storm exposure, costs outages, etc.

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Table 2
Net Debt and LCG Admin Charges
Current Situation ($000)

Item	Total
Net Debt as of Nov 2017 (1)	
Electric	$215,776
Water	19,338
Wastewater	31,254
Telecom	105,255
Total Net Debt	*$371,624*
LCG Annual Admin Charges (2)	
Electric	$1,818
Water	1,248
Wastewater	1,817
Telecom	725
Total LCG Annual Admin Charges	*$5,607*

Notes:

(1) Net Debt equals total outstanding principal as of November 2017, less bond reserve funds.

(2) LCG Administration Charges are associated with City services and are assessed to utilities monthly. Fiscal Year 2016 actual.

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Table 3
LCG – Estimate of Investment Value
Post Transaction ($000)

Electric System	Avg. Annual 2017 – 2027 (1)	NPV (2)	Telecom System ($000)	Avg. Annual 2017 – 2027 (1)	NPV (2)
Sources of Cash			**Sources of Cash**		
Cash from Sale (3)	$9,807	$1,087,076	Cash from Sale (3)		$172,532
Franchise Fee (4)	6,365	547,302	Franchise Fee (9)	$398	35,725
Ad Valorem Tax (5)	2,503	213,507	Ad Valorem Tax (5)	817	60,337
Subtotal Sources of Cash	*$18,675*	*$1,847,885*	*Subtotal Sources of Cash*	*$1,215*	*$268,594*
Unappropriated Cash (6)		17,960	Unappropriated Cash (6)		0
Total Sources of Cash		**$1,865,845**	**Total Sources of Cash**		**$268,594**
Uses of Cash			**Uses of Cash**		
Net Debt - Principle (7)		$215,782	Net Debt - Principle (10)		$105,255
Stranded Cost (8)		191,134	Stranded Cost (11)		67,277
Subtotal Uses of Cash		*$406,916*	*Subtotal Uses of Cash*		*$172,532*
Net Cash To LCG	**$18,675**	**$1,458,929**	**Net Cash To LCG**	**$1,215**	**$96,062**

Notes:

(1) Cash Flow projection based on LUS financial proforma's developed for the 2016 CER with certain recent updates.
(2) NPV of perpetuity with 3.2% discount rate and 2.1 percent growth rate. NPV represents lump sum investment that generates desired cash flow.
(3) Assumes LCG invests cash at 3.2% to create desired cash flow.
(4) Franchise Fee assumes 5% of Gross Receipts less sales to LCG and large C&I customers.
(5) Ad Valorem Tax assumes a 10.9 mill rate applied to Net Book Value.
(6) Unappropriated cash per LUS financial statements.
(7) Net Principle equals outstanding principle as of November 2017, less bond reserve funds.
(8) Stranded cost equal to LCG administrative costs paid by electric system (accounting, billing, etc.) plus a phase out of residual LUS administration and general costs.
(9) Franchise Fee assumes approximately 3% of CATV Gross Receipts.
(10) Net Principle equals outstanding principle as of November 2017. Excludes interdepartmental loan to the electric system of $28 million.
(11) Stranded cost equal to LCG administrative costs paid by telecom system (accounting, billing, etc.)

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Key Takeaway:

- Total Source of Cash = Transaction Value
- Transaction Value provided by buyer represents sum of cash, franchise fee and ad valorem payments to LCG
- LCG pre-and post-transaction values are equivalent.

Sale of Electric System

Benefits to LCG that increase asset value:

- LCG's largest utility operation representing two-thirds of utility revenues (including telecom)
- Financially strong and stable. Combined E, W, WW systems can backstop telecom debt with minimal upward rate risk (one time <3.5%)
    - Sale of electric system increases upward rate risk on W, WW systems (one time ~ 15%)
- Monopoly transmission and distribution system with captive customers results in reliable revenue stream
- Local control provides optionality with respect to project financings, combined system credit rating, economic development, ILOT, allocation of LCG A&G costs, local jobs, local investment, generation portfolio, rate levels, rate class subsidization, rate structures, economic incentive rates, etc.

Costs to LCG that decrease asset value:

- Complex and changing business environment requiring significant on-going investments
- Liabilities associated with employees, safety, reliability, storm damage and cost of outages

Sale of Telecom System

Benefits to LCG that increase asset value:

- Telecom is a net financial benefit to LCG
- Local control provides optionality with respect to economic development, rates & pricing

Costs to LCG that decrease asset value:

- Telecom must operate in highly competitive market
- No guarantee of profitable operation
- Highly changing technology requiring financial re-investment
- Combined electric-telecom asset sale adds value due to inter-utility loans, reduced rate risk, etc.

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Table 4
Value Comparison
Post Transaction ($000)

Electric System	LCG Investment Value Estimate	LUS Net Book Value	Fair Market Value (FMV) Estimate (1)(2)	FMV Estimate (3)
Sources of Cash				
Cash from Sale	$1,087,076	$375,300	$511,000	$596,500
Franchise Fee	547,302	547,302	547,302	547,302
Ad Valorem Tax	213,507	213,507	213,507	213,507
Subtotal Sources of Cash	*$1,847,885*	*$1,136,109*	*$1,271,809*	*$1,357,309*
Unappropriated Cash	17,960	17,960	17,960	17,960
Total Sources of Cash	**$1,865,845**	**$1,154,069**	**$1,289,769**	**$1,375,269**
Uses of Cash				
Net Debt - Principle	$215,782	$215,782	$215,782	$215,782
Stranded Cost	191,134	191,134	191,134	191,134
Subtotal Uses of Cash	*$406,916*	*$406,916*	*$406,916*	*$406,916*
Net Cash To LCG	**$1,458,929**	**$747,153**	**$882,853**	**$968,359**
Values Compared to Investment Value	**$0**	**($711,776)**	**($576,076)**	**($490,570)**

Notes:

(1) FMV determined based on 10 year DCF with terminal value. Assumed vertically integrated regulated utility with WACC of 8% for the transmission and distribution business unit and 10% for generation business unit.

(2) Assumes buyer will establish electric rates equal to current LUS rate projections.

(3) FMV determined based on comparable sale. Macquarie et al's 2015 acquisition of Cleco. Estimate based on ratio of purchase prices to net plant.

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Key Takeaway:

- Offer for purchase will not likely meet or exceed LCG's investment value.
- A significant contributor to the valuation gap is the difference between LCG's and purchaser's cost of capital.
- Potential for added FMV under electric rate increase scenario.

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Table 5
Value Comparison
Post Transaction ($000)

Telecom System	LCG Investment Value Estimate	LUS Net Book Value	FMV Estimate (1)(2)
Sources of Cash			
Cash from Sale	$172,532	$78,000	$133,838
Franchise Fee	35,725	35,725	35,725
Ad Valorem Tax	60,337	60,337	60,337
Subtotal Sources of Cash	*$268,594*	*$174,062*	*$229,900*
Unappropriated Cash	0	0	0
Total Sources of Cash	**$268,594**	**$174,062**	**$229,900**
Uses of Cash			
Net Debt - Principle	$105,255	$105,255	$105,255
Stranded Cost	67,277	67,277	67,277
Subtotal Uses of Cash	*$172,532*	*$172,532*	*$172,532*
Net Cash To LCG	**$96,062**	**$1,530**	**$57,368**
Values Compared to Investment Value	**$0**	**($94,532)**	**($38,694)**

(1) FMV determined based on one year cash flow with terminal value. Assumed unregulated telecommunications company with WACC of 10%.

(2) FMV assumes one time 9% increase in overall telecom rate revenues.

Key Takeaway:

- Offer for purchase probably will not meet or exceed LCG's investment value.
- A significant contributor to the valuation gap is the difference between LCG's and purchaser's cost of capital.
- LCG incentivized to sale:
  - Electric and telecom systems together, or:
  - The telecom system only
- Sale of electric system only is most costly scenario

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Table 6
Value Comparison
Post Transaction ($000)

Electric & Telecom Systems	LCG Investment Value Estimate	LUS Net Book Value	FMV Value Range – Low	FMV Value Range – High
Sources of Cash				
Cash from Sale	$1,259,602	$453,300	$644,838	$730,388
Franchise Fee	583,027	583,027	583,027	583,027
Ad Valorem Tax	273,844	273,844	273,844	273,844
Subtotal Sources of Cash	*$2,116,473*	*$1,310,171*	*$1,501,709*	*$1,587,209*
Unappropriated Cash	17,960	17,960	17,960	17,960
Total Sources of Cash	**$2,134,433**	**$1,328,131**	**$1,519,669**	**$1,605,169**
Uses of Cash				
Net Debt - Principle	$321,031	$321,031	$321,031	$321,031
Stranded Cost	258,411	258,411	258,411	258,411
Subtotal Uses of Cash	*$579,442*	*$579,442*	*$579,442*	*$579,442*
Net Cash To LCG	**$1,554,991**	**$748,689**	**$940,227**	**$1,025,727**
Values Compared to Investment Value	**$0**	**($806,302)**	**($614,764)**	**($529,264)**

Key Takeaway: Compared to current situation, transaction value expected to result in a loss of revenue to LCG on the order of $0.4 Billion to $0.8 Billion over time.

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July 19, 2017

White Paper on Franchise Agreement Negotiations

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Prepared by:

NewGen Strategies & Solutions

NewGen Strategies & Solutions

White Paper on Franchise Agreement Negotiations

NewGen Strategies and Solutions, LLC (NewGen) prepared this White Paper at the request of the Lafayette Consolidated Government's (LCG) Mayor-President. It is intended to identify negotiation points that will inform the City of Lafayette, Louisiana (City) and the Lafayette Parish (the Parish), collectively the City-Parish, officials with respect to developing a franchise agreement for operating an electric utility within the City limits. The assumption underlying the franchise agreement negotiation is that a third-party utility would purchase the City-owned Lafayette Electric Utility (Electric Utility or System), and operate that Electric Utility within the City under authority, and provisions of, a franchise agreement granted by the City. Typically, in such franchise agreements, privately owned utilities own and operate the electric utility within the city.

This White Paper is organized into five areas:

1. Basic Franchise Agreement Provisions
2. Strategic Issues
3. Employee Matters
4. Business Locations and Practices
5. Other Items

Certain of the items discussed in this White Paper may more appropriately belong in a Buy-Sell Agreement rather than a Franchise Agreement. They are included here, so that items to be negotiated in a sale are comprehensively presented in a single document.

Basic Franchise Agreement Provisions

An Electric Utility franchise agreement grants the franchisee the rights to operate and maintain electric service to customers residing within the City. These rights generally include the right to occupy and maintain electric utility facilities in public rights-of-way. The City grants the use of City-owned rights-of-way, and imposes conditions upon the franchisee for such use. Typically, these conditions include the following:

- Franchise agreement fee payment to the City
- Specification of the term of the franchise agreement
- Specification as to whether the franchise agreement is "exclusive" or "non-exclusive"
- Recognition that the utility properties will be subject to property tax treatment consistent with other taxable entities within the City.
- Agreement as to reimbursement of any separation costs, or other transaction costs of the sale of utility assets or incurred in establishing and granting a franchise agreement

Franchise Agreement Fee

The Louisiana Municipal Association (LMA) is a state-wide organization promoting and advocating for its members, Louisiana cites, and parishes. The LMA conducted a survey of its members regarding franchise

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agreement information in 2010. That survey indicated franchise agreement fees ranged from a low of 2% of utility revenues to a high of 5% of utility revenues. Based upon this information, it would be prudent for LCG to negotiate a franchise agreement fee at the high-end of percentages, perhaps starting at around 6%, with the expectation of agreeing on 5%. This fee is the single most important component of the franchise agreement.

Terms

The LMA's franchise agreement fee survey also contains information regarding the term of the utility franchise agreement. The terms ranged from a low of 3 to 5 years (mostly communications franchises) to a high of 60 years (for energy service provider, such as Entergy). Electric utility franchise agreement terms were typically in the 25-year range. When negotiating franchise agreement term lengths, the utility will generally want a longer-term in order to increase the certainty of the future business. The franchise agreement grantor may want a shorter-term, perhaps 10 to 15 years, so that the franchise agreement can be renegotiated with more contemporary terms as conditions in the electric utility industry and/or municipality evolve. Starting negotiations at the lower end, say 15 years, may be a good strategy for the City, with an expectation that a longer-term agreement may result. Terms longer than 25-years should be accompanied with other attractive features of the franchise agreement such as a trade-off, e.g. a higher franchise agreement fee or other City benefit.

Exclusivity

Typically, communications franchises are non-exclusive, recognizing that several communications providers may operate within a municipality. In the case of an Electric Utility, an exclusive franchise agreement is more common, recognizing that a monopoly provider is more efficient than attempting to accommodate competing electric utility providers. Indeed, the Louisiana Public Utility Commission prohibits dually certified utility service territories, so the issue of exclusivity is likely not a negotiation point.

Property Tax

The issue of property taxes is most likely governed by State of Louisiana (State) statute; however, it is worth acknowledging that there is no special treatment of utility assets sold to a third-party in this regard. Therefore, while property taxes on utility assets may provide revenue for a local municipality, they are typically not included as a negotiated item within a franchise agreement.

Separation Costs

Separation costs refer to the investment costs required to isolate service either through metering or in electric equipment when an existing system is divested or joined with another. Depending upon the buyer of the Electric Utility and the physical location of its current utility assets that will be used to serve the City, there may be some costs incurred to accommodate the provision of a new utility provider. The City should be held harmless for any such costs.

Strategic Considerations

There are several strategic considerations that need to be reviewed regarding the potential sale of Electric Utility assets and the development of a franchise agreement. These include the issues related to the existing Communications System, potential repurchase of the Electric Utility assets, and other considerations.

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Communications System

LUS's Communications System is a separate business entity from the Utilities System, and its revenues and expenses are generally not comingled with those of the Electric, Water, and Wastewater Systems. However, to finance the building of the Communications System, the Utilities System provided two forms of financial support. One was a provision for the Utilities System to provide direct loans to the Communications System in the amount of $6 million (M). The other form of support is a credit guarantee by the Utilities System that provides a financial "backstop" to the Communications System revenue bonds of which approximately $105M are outstanding.

A review of the Utilities System Bond Ordinance and the Communications System Bond Ordinance does not appear to prohibit the sale of a portion of the Utilities System, so long as the rate covenant is not violated, among other issues. That covenant requires the City to maintain rates for services at a level allowing 100% of debt service to be maintained. The practical effect of this provision is that, without the Electric System, should the Communications System fail, or operate at a loss, Water and Wastewater rates would have to be set high enough to cover the Communications System losses, and pay the Communications System debt service. Under a "shut down the business" scenario for the Communications System, the Water and Wastewater Systems would have to assume, or defease, $105M of Communications System bonds.

While the Utilities System, consisting of all three utilities, provides the financial backstop, as a practical matter, it is the size and strength of the Electric Utility that provides the bulk of the financial support. Should the Electric System be sold, the continued financial backing of the Communications System bonds would not be prudent or practical as the combined Water and Wastewater Systems do not have the financial strength to offer such support. This may jeopardize the financial integrity of LUS.

Because such a result would represent a severe financial challenge to the Water and Wastewater Systems, it may be prudent to combine the sale of the Electric Utility with a corresponding sale of the Communications System. A simple approach to this problem could be to negotiate the sale price for the Electric Utility, and then add a premium cash payment of $105M for the outstanding debt. The City could defease the Communications System bonds, and continue to operate the communications business as it desires. This approach may result in a joint bid between electric utility and communications providers, which may be a challenge; however, from LCG's perspective it would offer a viable solution to the Communications System issue.

Finally, there are many aspects of LCG and the Water and Wastewater Systems that rely on the existing configuration of the Communications System to operate. A future franchise agreement will need to specify the details of how the remaining systems will utilize the Communications System, and if such use would be subject to compensation and certain operational metrics.

Re-Purchase of Electric Utility Assets

It is not uncommon for utility franchises to contain a clause specifying franchise agreement renewal provisions or rights of the grantor at the end of the franchise agreement term. The City should consider including a provision that gives the City the right to re-acquire the electric utility at the end of the franchise agreement term. This right should also specify the price (or the methodology to determine the price) that would be paid to re-acquire the utility assets. Such a price would typically be based upon net book value of the utility assets, but could be negotiated higher if required. The more detailed the methodology included in the franchise agreement, the easier it will be to evaluate such re-acquisition years later at the end of the franchise agreement term.

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Other Strategic Issues

There are other strategic issues that LCG should consider before entering into an electric utility franchise agreement. These include items specific to the industry such as pursuit of a renewable portion of power supply, conditions regarding Automated Metering Infrastructure (smart meters), or smart grid accommodations, as well as access to the data provided by such systems. A more thorough review of energy franchise agreements in Louisiana and across the country should be conducted prior to initiation of a franchise agreement with a third-party purchaser of the Electric Utility.

Employee Matters

A sale of the Electric System necessarily requires negotiations, in detail, of how current Utility System employees will be treated. Retention, salaries, benefits, jobs eliminated, and severance payments are just a few important matters to be resolved before a sale can be consummated. Of particular importance is how current and past employees' retirements will be affected. Assuming LUS is largely operating on a "pay as you go" basis for retired electric utility employee benefits, how will those payments be managed going forward? Many publicly -owned utilities have Other Post-Employment Benefits (OPEB liabilities), of which pension obligations are typically the largest and are a continuing financial obligation of the utility. We have not researched how the Louisiana Association of Public Employees Retirement System (LAPERS) works in this regard; however, this will need to be included as a consideration.

While sale of the electric utility may result in some employees being retained, (e.g. line crews and other crafts positions), it is expected that sale would result in a direct reduction of some current electric utility employees. We have not studied how likely, or how many positions, may be eliminated, but it is reasonable to assume the reductions would be significant. These reductions would, at a minimum, require severance payments consistent with current LCG termination policies. These severance payments would also apply to Communications System personnel as well, assuming sale of that system. We have not performed a detailed study of these severance costs; however, our knowledge of LUS suggests that severance on the order of $5M is not an unreasonable expectation.

Business Locations and Practices

The franchise agreement negotiations should include a requirement for the maintenance of business operations within the City. In particular, negotiations should ensure that the City's citizens have similar convenience and access to their utility provider as they currently have with the LUS Electric System. Arrangements for bill payments are likely straightforward; however, the matter of access to utility officials for complaints, service outages, service requests, meter changes, and other day-to-day utility matters should be specified in the franchise agreement.

Other Items

The primary purpose for the City to grant a franchise agreement for utility service is to recognize, and permit, the use of City-owned public rights-of-way to the franchisee. This allows the utility to construct, operate, and maintain facilities in the City's rights-of-way. The franchise agreement should specify any requirements the City wants to impose on the utility for conditions to occupy the rights-of-way. Considerations such as overhead and underground street crossings, street cutting and repair requirements, permits and license requirements, and accommodation of new street alignments are all items that should be documented.

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The Communications System uses space on Electric Utility poles for its communications facilities, and the franchise agreement should specify that such use is anticipated, and how it will be accommodated. A pole attachment fee may apply, or be subject of a separate pole attachment agreement. Even under sale of the Communications System to a third-party, the franchise agreement should anticipate, and provide for, the City's use of utility poles for internal communications facilities. LCG may also require communications facilities on utility poles.

LCG has a contract with the Southwestern Power Administration to purchase 23 megawatts (MW) of federal hydropower. This contract cannot be assigned to a third-party buyer, and that should be clearly noted in any franchise agreement negotiations. The contract is set to terminate in 2018; however, a contract extension is likely.

Conclusion

This report is intended to address the key features needed for the City to offer a franchise agreement to a third party, electric utility provider. In the course of negotiating a franchise agreement, other items may arise that have not been considered here. Because utility franchises are long-term commitments, the City should take the time to carefully consider each franchise agreement provision, and the associated benefits and commitments. Should the City embark on such an effort, it should enlist the expertise of LUS management, as well as outside expertise as needed so that a favorable, long-term, and beneficial franchise agreement results.

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