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HEARING BEFORE THE WASHINGTON STATE SENATE

ENERGY AND UTILITIES COMMITTEE

WPPSS INQUIRY

1:15 p.m.

September 25, 1980

1310 IBM Building

Seattle, Washington

Patricia Uchida

Court Reporter

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A P P E A R A N C E S

COMMITTEE MEMBERS:

SEN. R. TED BOTTIGER

SEN. SUSAN GOULD

COMMITTEE STAFF:

DON VOGT

JIM ZIMMERMAN

DAVID NEAL

1 MR. VOGT: Bill, why don't you just start when
2 you like. I think I should mention just for a second
3 that Jim and I had met with Bill about ten days ago or so,
4 and in a preliminary way to kind of get picked up to
5 speed on the financial aspects of WPPSS, which is an area
6 which we haven't really spent a lot of time looking into.

7 He was very helpful in explaining a number of
8 factors about why WPPSS is organized the way it is, how
9 it obtains money, what the long-term financial picture
10 for WPPSS looks like and so on.

11 So I think Jim then had a chance to talk to
12 Senator Bottiger, sort of filling in on that. And I
13 guess that's sort of where we are at the moment.

14 So, Bill.

15 MR. APPEL: Let me say first that, let me tell
16 you something about myself, so if there are either holes
17 or inadequacies or if I overstress certain things, you
18 might have an idea of who I am, what my experience is and
19 why I put it the way I do. Maybe this is an unusual way
20 to start, but I think we have an unusual area to discuss.

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1 So I'll just tell you that about 15 years ago
2 I started practicing in Philadelphia, and my practice was
3 split between banking and commercial law and municipal
4 bonds. And at that time with my father, who had spent 40
5 years then in municipal bonds, we did bonds like the
6 Pennsylvania Turnpike, which were then the largest issue
7 I'd ever seen anywhere. And at the same time I was
8 working on utility financings for what is now DELMARV
9 Power & Light but was then Delaware, Virginia, Maryland
10 Power & Light Company. In 1967 I became a member of the
11 bar here and focused for about six years on strictly
12 commercial types of financing transactions.

13 About seven years ago I came to this firm, and
14 since then my practice has been split between commercial,
15 financial and municipal bonds, which is what it is now.
16 The reason I say that is because I have not attempted to
17 do only one thing, like municipal bonds all the time. I
18 will say in this firm, my main experience is with
19 different types of revenue bonds and different types of
20 financings, such as conditional sales contracts, the
21 interest on which can be tax exempt under certain
22 circumstances. There are a lot of other ways of doing
23 municipal financings other than just what people call
24 bonds or a package or other common ways to put things.

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1 What I thought I would do here is simply to
2 give an idea about why the WPPSS transactions work the
3 way they do, what the reasons for them are and the -- I
4 think the best way to start is to explain, generally
5 speaking, how borrowing works, because we're not talking
6 about the kind of investment that one would make in a
7 securities transaction, equity stock, debentures and
8 other devices. We're talking about straight borrowing.
9 And so when I talk about the structuring of these
10 transactions and why they work, why they're so marketable
11 in the face of the possibility that the things which are
12 being financed might never work, and from the investment
13 community they never have to, I want to explain how this
14 works this way and why it works this way and why it's
15 still so salable.

16 So let's start out, I guess, with the bottom
17 line where we've all been, and I still am, which
18 essentially is if you want to go to the bank and you want
19 to borrow money, you still sign a note and they give you
20 the money. And that's called, of course, a signature
21 loan. It's unsecured, you signed a promissory note. And
22 most of us engage in transactions like that. Charge
23 cards work very similarly.

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1 But the minute you step up an order of
2 magnitude to buying a house, that's not something that
3 probably anybody in this room can simply buy a house on a
4 signature. That's a substantial transaction. And so
5 there you have to do more than to sign a note saying
6 you'll pay the bank what it loans you for the house,
7 you've got to give the bank some assurance that not just
8 you but an asset will be available to pay that debt back.
9 And so most of us have bought houses in that fashion,
10 although there is a real estate contract which has a very
11 similar effect. In that case, the house is still
12 available to the seller if you don't pay. And when I
13 refer to security, I'm talking about the house in each
14 sort of situation.

15 Now, sticking with this kind of a way of
16 looking at it, let's suppose you wanted to go into
17 business and you wanted to buy a hotel. Now, of course
18 that's larger than a house, and one of the things about
19 hotels that are so much larger is that sometimes one
20 lender isn't enough. You could say it was a hotel with
21 10,000 rooms, it would be a billion dollars. So that we
22 get very quickly up to the magnitude we'll be talking
23 about, and you find that you can't find anybody who can
24 lend a billion dollars on a project.

25

1 Well, that problem was solved many years ago,
2 and the way it's done is to say, all right, there will be
3 a promissory note. In fact, there might be 10,000
4 promissory notes, probably about 20,000 in the case of a
5 billion dollar loan. Each note would be \$5,000 worth.
6 There would be still a single mortgage on the hotel.
7 That way, it's possible to take those 20,000 notes and
8 sell them to people, get them to invest. Nobody invests
9 more than \$5,000 or some multiple of it. You're still
10 dealing with people who are willing to lend, and they say,
11 "What is the security?"

12 And you say, "Isn't my signature enough?"

13 And they say, "No."

14 And then you point to a mortgage on the hotel,
15 "See, you have an interest in the hotel."

16 Now, at this point you have to think a little
17 bit just to understand a couple more steps that intervene
18 because of the size of the transaction this involves.
19 One is that there is only one mortgage on the property,
20 and everybody who holds a note shares in that mortgage,
21 so that nobody has a higher priority than anybody else.
22 That makes it very simple.

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1 The other thing is some other people come into
2 a transaction like this that didn't come into the
3 transaction before. And these are people who, when you
4 go into this hotel plan, you say, "How can I reach all
5 these people to sell these notes? I don't have any money,
6 unless I do sell the notes, I can't do it."

7 So you meet somebody who says, "My business is
8 selling notes." We call them an underwriter. And that
9 person simply is a salesperson for your debt. They do a
10 lot of other things, too, but for purposes of this
11 conversation that's all they do.

12 Of course they say, "Now, you understand, you
13 haven't been in business before. And your track record
14 isn't very good, so there is an investment risk. I'll
15 have a hard time selling these notes."

16 And you say, "Well, let me see. Mortgage
17 rates right now are 15 and a half percent for commercial
18 loans, will you give me 15 and a half percent?"

19 And the underwriter says, "No, I don't think
20 so, because you're new at it. But if you add two and a
21 half points and go to 18 percent, I think I can sell it
22 in a negotiated transaction."

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1 Something like that occurs whether the
2 transaction is a large hotel, whether it's a ship being
3 financed, or whether it's municipal bonds, the
4 conversation I've just outlined to you takes place in one
5 form or another. Sometimes it's very polite and over a
6 couple drinks in a bar or in a private club, sometimes
7 it's over a desk in an underwriter's office where it
8 takes sometimes more argumentative forms. But sometimes
9 they say, "Well, let's see" -- and then another person
10 comes in -- "what the rating agency says."

11 Historically what's happened is that the
12 underwriter doesn't really know, looking at one
13 transaction at a time, has never really looked at this
14 transaction in terms of how things go in the market.
15 Generally, the competition from moment to moment is
16 simply too fast.

17 So they look, the underwriters, to a more
18 stable definition of what a good investment might look
19 like. So here come in the rating agencies, Moody's,
20 Standard and Poors, and a number of other companies whose
21 job it is to give people some comfort that the
22 transaction was looked at, just the way a banker would
23 look at the first mortgage at that time.

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1 So what happens often is either papers are
2 simply mailed to New York and Moody's and Standard and
3 Poors look at the papers. The time spent on review is
4 very short, 20 minutes, never more than an hour that I
5 know of. Sometimes an hour and a half presentation, but
6 the actual work by the rating agencies is very quick.
7 They have a check list, they know what to look for.

8 There is now information out publicly about
9 what they do look at, why they look at it. What they do
10 look at is changing, because of New York. It's changed a
11 lot of criteria for rating bonds. But this way you have
12 a third party, the underwriter, our first new person, who
13 is able to say, "Well, your rating on these bonds isn't
14 very high, is it?" And he is able to use the rating with
15 the issuer or the borrower, not only as a kind of club,
16 but also as saying, "This is the indication of how
17 difficult these bonds are to sell." Because the ratings
18 are always public once they're acquired. And, of course,
19 the idea is to get as high a rating as possible, and the
20 higher the rating, of course, the more assets you have.

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1 We're talking now ultimately about a peculiar
2 kind of debt, so we'll be talking about a more limited
3 range of rating. But in short, the corporations and
4 municipalities who have ratable bonds or large bond
5 issues, and they have ratings to sell at all, they're not
6 just small banks or local investors, but generally
7 nationally they have a rating, the underwriter puts out
8 an extensive document, and you've all seen this one, but
9 this is essentially it, giving the possible investors
10 information.

11 The underwriter also does something else. The
12 underwriter says, "Well, we get paid by making a profit
13 on the sale of these bonds." What we're going to do is
14 sell them at a price of approximately par, \$5,000. for
15 each \$5,000 piece, but we are not going to pay you \$5,000
16 for every piece. We're going to pay you two percent less
17 than that and that's going to be profit. And we have a
18 lot of expenses," and you hear about the printing
19 expenses and lots of things, which lot of times are
20 passed on to the borrower anyway, because the costs of an
21 underwriting of a substantial size are very large.

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1 In any event, this is how, whether it's a
2 municipal transaction or whether it is a corporate
3 transaction, what I've described works the same way.
4 There is a variant, and this has to do with peculiar
5 financings. Because the ability of the underwriter to
6 quote a low interest rate for the bonds, to agree to buy
7 the bonds at a low interest rate, has to do with how fast
8 that underwriter can sell those bonds. There is a lot of
9 creativity in the area of debt financing, but creativity
10 has a very high price.

11 And here we get into the area of what I call
12 story bonds, and I got that name from an underwriter,
13 where what happens is when bonds are being sold to the
14 public but they have a peculiarity that isn't true about
15 other bonds generally known. People already know, and
16 I'm sure you already know, about what are called revenue
17 bonds, and that's the security by revenues from an
18 operating facility. There, of course, are general
19 obligation bonds of various types, but generally speaking
20 they're paid from taxes.

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1 There are other types of bonds like assessment
2 bonds or peculiar types of revenue bonds which have to be
3 explained, and the more unique of these bonds are called
4 story bonds. And a story bond is one where the
5 underwriter salesperson is talking to a prospect over the
6 phone and says, "I've got a really hot bond for you."

7 "What is it? Is it GO or revenue?"

8 "Well, it's revenue but." And with the "but"
9 comes the qualifications that outline perhaps someone's
10 ingenuity with the financing, but also really qualify
11 investors' simplified confidence in understanding the
12 transaction, knowing what they're investing in.

13 And so what happens is that two things happen.
14 And it happens very quickly, and it might be over in 45
15 seconds. A lot is said in 45 seconds. It might be "Well,
16 I don't know that we've got a place for those in our
17 portfolio" or "I wouldn't touch those below nine and a
18 half percent per annum."

19 Those kind of expenses are very large in an
20 issue, as the issue gets very large. And this is why,
21 when the underwriter is doing the job of either assisting
22 in structuring a bond issue as a financial advisor or in
23 negotiating for the sale of bonds, they want the simplest
24 possible transaction with the strongest possible credit.

25

1 As an example, looking at this -- what we're
2 going to discuss today is pretty complicated, but when
3 these bonds come out on, let's say, nuclear project
4 number two, all they've got to say is, "I've got some
5 great tax exempt bonds and they're payable by a
6 government agency, Bonneville."

7 And that's all they have to say. The
8 conversation doesn't have to go any further. They don't
9 have to talk about public utilities, they don't have to
10 talk about what the City of Seattle or Hoquiam or
11 Aberdeen or where they're going to put it, because they
12 know ultimately the way the agreements are drawn. And
13 that's the way it's explained in here. There is an
14 indirect federal credit. Not a direct federal credit,
15 there is an indirect federal credit.

16 Let me go into one more area and then I'll
17 open it up to questioning. Before I go into the
18 structuring of these bond issues, I want to explain the
19 idea, the emotional idea of what a bond issue is the only
20 way I can.

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1 When the New York Housing Authority bonds went
2 into default, they went into default because the New York
3 legislature refused to appropriate the money to pay them.
4 Now, the New York legislature had no obligation to
5 appropriate the money to pay the bonds. They're called
6 "moral obligation bonds." When John Mitchell thought
7 that up, what he had done was think up a way that people
8 would say "that's New York," "that's New York Housing
9 Authority bonds."

10 And New York at the time was handling its
11 credits aggressively and, incidentally, attempting to get
12 higher ratings for all its bonds. The Housing Authority
13 bonds were peculiar because everybody knew that the
14 legislature did not have to appropriate the money to pay
15 those bonds, but the assumption was that who in their
16 right mind would allow the legislature not to. New York
17 State certainly wouldn't. Why wouldn't it? It didn't
18 have to pay, and the reason was because New York State
19 knew, and it turned out to be totally correct, that if
20 they didn't pay those bonds, the state credit, the entire
21 state credit would suffer.

22 This is where we have the forty second
23 conversation. "I've got some New York Housing Authority
24 bonds."

25 "They're into default."

1 "I've got some New York GO's."

2 "I don't like New York."

3 Why doesn't he like New York? Because of the
4 New York State Housing Authority.

5 Now, that brings me to the naming of WPPSS.
6 You'll notice that WPPSS is not really a state agency at
7 all. It doesn't bind the state or anything, but what is
8 the first word in its name? So if it ever comes to the
9 legislature to make a decision about that credit, what
10 kinds of pressures do you think will be working on the
11 legislature?

12 SENNATOR BOTTIGER: Is your point that if for
13 some reason WPPSS defaulted and we didn't pick up their
14 bonds, then the next highway bond would be unsalable?

15 MR. APPEL: Bonds are never unsalable. If you
16 went into a pawn shop to borrow money, they would turn
17 them. This state will always be able to sell its bonds.
18 It will have an effect. It will have an effect at two
19 places, because the market occurs at two places. It has
20 an effect at the underwriting level, where the
21 negotiation between the underwriter and the issuer takes
22 place. That would be the state finance committee in
23 setting up, in accepting, perhaps, a public sale of bonds
24 in this case. But it also occurs in the secondary market.

25 There are two markets for bonds. One, as I've

1 just described, and the second is a couple years later
2 after the bonds have matured in the sense that a couple
3 of years of interest payments have been made. People buy
4 bonds that have been outstanding a few years because if
5 if they're outstanding for a few years, like a real
6 estate contract, the payment record is good and the
7 interest is lower.

8 But they have the name "Washington" on it, so
9 just like a corporation that may be doing something at
10 one end of its financing scheme, its securities already
11 out in the field keep varying according to what the
12 stockmarket reflects by the interest in the secondary
13 market. So both markets have to be considered, because
14 the state of Washington will know that if there is even a
15 common person -- this is why the story bond is so
16 dangerous -- if the common person, the common investor,
17 the trust officer who does not have time for a portfolio,
18 because if they have extended a bond time after time, the
19 trust company doesn't make money. And here it says the
20 "State of Washington." That says "No" right away.

21 The underwriter companies start hearing about
22 it, because it's their salespeople that are selling these
23 on a secondary market, and if these salespeople are
24 having trouble selling Washington bonds, then the
25 underwriters are going to have trouble.

1 Let me tell you why it's so serious for the
2 underwriter. The underwriter isn't just agreeing to
3 market the bonds for the investor, the investor is
4 agreeing to buy those bonds. If the underwriter cannot
5 resell those bonds, that underwriter has simply become
6 the largest bond holder of those type of bonds. It is
7 legally obligated to pay for them.

8 The billion dollar IBM issue that was just
9 about this time last year that was being issued was a
10 pretty good issue until October 6, 1979, when the Federal
11 Reserve Board acted and changed the interest rate where
12 suddenly with -- I don't know how many million or
13 transactions of a hundred million or multiples of a
14 hundred million of those bonds hadn't been sold -- the
15 market changed. And all of a sudden they became a lot
16 less attractive, because with money rates going up, other
17 investments were better.

18 And the underwriting pool or syndicate which
19 has agreed to buy those bonds were caught with those bonds
20 unsold. And they had to what's called "break the
21 syndicate." That means you dump the bonds and sell them
22 for whatever you can and take your loss and get out.

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1 And remember, the underwriters themselves have
2 problems, because they're not rich. They act rich, they
3 look rich, they think rich, but they're not rich. They
4 borrow from banks and they're looking at a banker and the
5 banker is saying, "We still have \$150 million of IBM
6 paper. When are you going to sell? The market just
7 changed, what are you going to do?"

8 And the underwriter, of course, is a human
9 being, and he says, "We're discussing a break."

10 Obviously, the underwriter can't say anything
11 more than that for a number of reasons. But at that
12 point the market breaks and everything is sold, and the
13 underwriter takes their profits.

14 So in answer to your question, the underwriter
15 will make absolutely certain that any risk of loss is
16 minimized, and they will build in a cushion against any
17 problem that they foresee on a negotiation.

18 Now, the same thing is true with even, whether
19 they negotiate or not, is true with a public sale. It's
20 commonly believed that if you have a public sale things
21 will be competitive, the best, most price will be
22 realized. And generally speaking, that philosophy is
23 reflected in a number of state statutes requiring public
24 bidding for contracts, construction contracts, and in
25 many areas that makes a lot of sense.

1 In bonds, however, so much advance work has to
2 be made in selling that by the time a bid is submitted in
3 a public sale bond transaction, the underwriters put a
4 lot of money into it. In fact, they have attempted to
5 presell a lot of bonds in order to eliminate the risk.
6 Remember, if they can presell those bonds or they have
7 buyers in their pocket, the less risk they take. So they
8 spend a good deal of money doing this. Of course, if you
9 have a number of bidders doing that, they're all spending
10 money, they're all building that into their bids. When
11 you would think that the force would go downward, in fact
12 they have extra costs because they know they have to have
13 a loss cushion. And they would rather lose the deal than
14 take that loss, because they see an underwriter's loss as
15 a sudden death loss. There are no outs. There are some,
16 but not generally speaking.

17 In the case of WPPSS, I have to say frankly it
18 is a, for the purposes of getting the money, there is no
19 question it is a brilliant way to do it in terms of
20 getting the money into a vehicle to provide for massive
21 construction. The drawback is that the stronger the
22 transaction becomes as a financial vehicle, the less
23 assurance there is that any service will necessarily be
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20 getting the money into a vehicle to provide for massive
21 construction. The drawback is that the stronger the
22 transaction becomes as a financial vehicle, the less
23 assurance there is that any service will necessarily be
24 rendered.

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1 Let me tell you just a little bit about the
2 WPPSS bonds, which you probably already know, but the
3 short of it is that in essence it was designed to enable
4 utilities to draw on an area of technology which no one
5 utility could possibly bear. But as utilities, of course,
6 utilities make all their money by charging rates for
7 services rendered. WPPSS is a joint venture, so when the
8 utilities joined WPPSS, they took on percentage liability
9 in accordance with what were their interests for whatever
10 WPPSS did.

11 Except in one case that I'm going to discuss
12 later, utilities cannot raise any money at all on a
13 business basis, unless they render services for it.
14 WPPSS is not a utility, it's a vehicle for utilities, and
15 it is the beneficiary of contracts which assure that it
16 gets paid as a consortium, whether or not it ever renders
17 any services at all.

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1 Now, the advantage of that, instead of having
2 the members themselves build projects, even jointly in
3 the normal sense, is that they could not raise any money
4 without actually selling energy from somewhere. By
5 making W2PSS a municipal organization separate from the
6 utilities themselves, an organization was created that
7 was not impaired by the utility laws that say, generally,
8 in a general context, you cannot receive money unless
9 you're delivering a service.

10 SENATOR BOTTIGER: But Tacoma City Light,
11 Seattle City Light, Chelan County PUD, they all issue
12 bonds to build things.

13 MR. APPEL: That's right.

14 SENATOR BOTTIGER: But in their own capacity.

15 MR. APPEL: That's right.

16 SENATOR BOTTIGER: But that isn't what I
17 understood you said, that they can't raise any money
18 because they're selling a service.

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1 MR. APPEL: Let's suppose it weren't Seattle
2 City Light, but let's suppose in an undeveloped portion
3 of King County I incorporated a town with 4,000 people
4 per square mile, which is what it takes to incorporate a
5 fourth class city. We decided to have an electric
6 utility. We wanted to borrow money to build that utility,
7 but unfortunately everybody in that town used kerosene
8 lamps and didn't use any electric power. Under our
9 present law, that utility cannot borrow because it has no
10 way of paying back that loan, because it must have sales
11 of energy.

12 So yes, Tacoma City Light and Seattle City
13 Light can issue bonds, because they have a rate base of
14 customers for services rendered which can pay those
15 bonds, and they can increase those rates if they have to
16 borrow more money. And in fact, the way they get around
17 what otherwise might be a complicated rate-making process
18 in some extent, is they covenant with the first lender
19 they can find who says, "We'll keep your ratings good and
20 high." Every time a rate lender wants to complain, they
21 say, "We have a covenanted bond holder, we can't break
22 our covenant." And under state statutes, the bond holder
23 has the right to come in and raise the rates. I'm not
24 talking about half of the customers or anything, I'm
25 talking about overall.

1 So the utility is assured that it has a rate
2 base. If you start a utility, you couldn't possibly do
3 this this way. You would have to use a different source
4 of money.

5 Incidentally, there is available under state
6 law a mechanism for doing it, but not for charging rates.
7 What you would have to have is a voted bond issue for a
8 municipality in this state to do this.

9 MR. VOGT: That's what you are saying, why
10 WPPSS isn't a utility, because if it were a utility it
11 didn't have anything to do.

12 MR. APPEL: That's right. It had no rate base.
13 What it did by having participants was enable it to reach
14 into the rate base of utility members and thereby get the
15 profit -- and I don't mean the profit in a negative sense --
16 and thereby benefit from the existing rate bases of
17 established substantial utilities without having to
18 generate any rate base of its own.

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1 And that removed the one criteria for a
2 utility, you have to have something to sell. And perhaps
3 at the time everybody thought it was a simple matter and
4 all they had to do was make a slow-moving atomic bomb and
5 generate the heat and have a lot of steam and really
6 generate a tremendous amount of power. And that was as
7 close to getting something for nothing in the 50's as
8 anybody knew. And heaven knows, I was growing up in the
9 50's, I was on board. But that is the reality, and the
10 result is that the members to the extent of their
11 participation in WPPSS must raise the money somehow.

12 Now, the advantage to the public utilities,
13 Seattle, Tacoma, Chelan PUD, Snohomish PUD, is that they
14 can say, "We seem to have entered into this contract.
15 Our overhead has now increased by this amount of money.
16 That is now in our rate base." So their rates just make
17 a jump and they'll just keep making jumps for whatever
18 are necessary.

19 Now, as far as the WPPSS contract is concerned,
20 what we've discussed are basically how it works for four
21 and five. Let's look at the early ones, and just let me
22 tell you how Bonneville fits into this and why it's even
23 better.

24 Dropping back for a minute, without Bonneville
25 all WPPSS is selling is effectively the participating

1 credit, percentage credit of its members as utilities.
2 It's like it's not really a chain, they're all in
3 parallel and they get to draw a percentage from each
4 utility. If one utility fails to pay, then the interests
5 of that utility go up to a percentage being assigned and
6 moved around to some degree.

7 And there may be some penalties, but generally
8 speaking each utility is absolutely and totally bound.
9 It has to be more strongly bound in order to assure the
10 bond holders that the people who really have to pay,
11 which are the various utilities, cannot get out. Because
12 it is the utilities' credit that's being sold. That's
13 what's really for sale. WPPSS has no credit at all. How
14 could you sell bonds secured by a mortgage on an
15 incomplete nuclear plant? And so basically you look for
16 a different kind of security, one that will "sell." And
17 the way you do it is when you have these forty second
18 conversations saying, "I've got a really hot one for you.
19 I've got some great utilities joined in consortium and we
20 have got them, none can back out. Ready to buy?"

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1 "Sure." That's better than one utility. What
2 you've got is a utility bank, the way you have for a
3 municipal, you know, a pool, a utility pool. Bonneville
4 is the frosting on the cake, because Bonneville allows
5 something even better to come along, and it's unique on
6 really two points. You can almost tell by looking at the
7 fact that, I forget how many, but, well, 103 or 104
8 signed on when Bonneville signed on, and only 88 signed
9 on when Bonneville didn't. It was some of the large ones
10 that had questions when Bonneville didn't. The reason
11 for that is Bonneville has some peculiarities.

12 First, let me drop back a minute about the
13 effect of Bonneville. When I switched from the hotel to
14 discussing WPPSS, I made a large jump, and the jump was
15 in the kind of investors that would be interested and the
16 reasons that the investors would be interested in
17 participating in those loans.

18 The investors that buy the WPPSS bonds are
19 investors who are looking for income, interest income on
20 which they will pay no federal income tax. And that's
21 the difference between, as far as the interest taxation
22 is concerned, between the WPPSS bonds and the hotel bonds
23 we were discussing and other corporate commercial bonds.

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1 In the early part of this century, the United
2 States used to borrow money in order to enhance its own
3 attractiveness. It had an exemption for interest on its
4 own obligations. But I believe well before the
5 depression that stopped, and I don't believe there are
6 any more federal obligations that are outstanding which
7 are not taxable under federal law. So that the United
8 States giveth and the United States taketh away.

9 But the WPPSS transaction was a brilliant
10 maneuver around that, because everybody, every United
11 States agency obligation that I can think of, interest on
12 it is taxable. You buy JENNI MAE, you buy FANNI MAE
13 securities, you buy securities of the various land banks
14 and cooperative banks and various other agencies, and the
15 interest on those obligations is taxable under federal
16 income tax. And I suppose if you bought, and I believe
17 if you did, if you bought Bonneville Power Administration
18 Bonds that interest is taxable. It's a United States
19 agency.

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1 When you get to one and two of the nuclear
2 projects, what you have is Bonneville's credit directly
3 behind those bonds, but interest on those bonds is tax
4 exempt. And that's why I have a lot of respect for how
5 this transaction is set up. An investor who buys the BPA
6 backed bonds has the benefit of a federal agency credit
7 at a state tax exempt rate. This, in one sense it
8 belongs to the category of how can anybody lose? We can
9 get to that later, but as far as the investor is
10 concerned, nobody loses. The investors get federal
11 credit at a tax exempt rate, and there isn't anything
12 else like that on the market.

13 SENATOR BOTTIGER: Federal credit meaning
14 security?

15 MR. APPEL: That's right. You've got the
16 promise of a federal agency to back up those bonds. If
17 you went to Bonneville and got it directly, you would pay
18 interest on that.

19 SENATOR GOULD: You said that the utilities
20 cannot go out of business. They can not withdraw in any
21 way at all?

22 MR. APPEL: There are some things they can do.

23 SENATOR GOULD: Could they go bankrupt or is
24 there some way that they can --

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1 MR. APPEL: I would like to treat this as a
2 separate section, because I do have some ideas of what
3 their options are.

4 SENATOR GOULD: Okay.

5 MR. APPEL: At that time, I'm going to ask
6 that the court reporter not take it down.

7 MR. VOGT: That's fine. Whenever you feel
8 that, we'll just let Pat know.

9 (Discussion off the record.)

10 MR. APPEL: Let's look for a moment at one of
11 the responses to this of the users. The users are us,
12 utility users. And we're looking down a long pipe and
13 we're at one end of it. We have to keep putting money in
14 that pipe, because as long as we use any electricity that
15 pipe is to going to expand and take enough money out of
16 us to pay our share, whatever it is. We know, because
17 the rate covenants provide it, that the rate covenants
18 will be adjusted for enough money to flow. As an extreme
19 example, if the rate base dropped in half, the rates
20 would simply double or do whatever was necessary in order
21 to make sure that the cash continued.

22 But let's suppose you followed the views of
23 the Pennsylvania Dutch, and I am one, who don't use any
24 electricity at all, but I do use electricity. You cut
25 the wires into your house and didn't use any electricity.

1 You have disconnected from the utility. What
2 do you think the response of the utility would be to a
3 large number of people doing that, aside from doubling
4 the rates for existing users?

5 SENATOR BOTTIGER: I don't know.

6 MR. APPEL: Let me give you an example of what
7 has happened in other areas. Let's suppose you made your
8 house so energy-efficient, which could be done, and you
9 used solar heat to heat the house. You didn't need
10 electricity for that purpose and everything else ran off
11 of energy mechanically generated and you went to bed at
12 sundown.

13 The sewer districts have that problem in this
14 state. The problem with sewer districts is they have to
15 put in a large amount of utilities for developments which
16 might not get sold right away, and the houses may or may
17 not get put in.

18 So not too many years ago, they got a statute
19 passed that allows them to charge rates for service if
20 it's available. And the court has upheld it, and I've
21 litigated it and the Court of Appeals thinks it's fine.
22 Not only can you charge rates if it's available, but if
23 you refuse to pay those rates for service that is
24 available, you have a lien on your property which can be
25 foreclosed.

1 In your area we foreclosed on a large
2 development at Lake Stevens, which was under that same
3 theory, and it was upheld.

4 It's my view that electric utilities will
5 respond to conservationism -- disconnection is an extreme
6 case of conservationism. One response would be to say,
7 "We now have so much more power available than is
8 necessary that we're going to charge you for what we made
9 available to you. You're going to have to pay that."

10 It's not unconstitutional. At least, it
11 hasn't been at the time held to be unconstitutional.

12 SENATOR BOTTIGER: Will they do this under
13 their own police power?

14 MR. APPEL: I believe what will happen is the
15 legislature will be asked to pass a statute, and the
16 legislature will have one or two choices. It will be
17 presented by a lobbyist in this fashion: "Either the
18 State of Washington takes over this credit or we make
19 absolute certainty" -- after all, that doesn't mean they
20 won't be back next year with something else --
21 "absolute certainty right now that because of the number
22 of disconnections and the impact of what the
23 conservationism people have been doing, since we cannot
24 raise our rates for constitutional amounts, we need now
25 to charge for empty lots.

1 "We need to charge for large amounts of blocks
2 of utilities which we have available but we can't sell
3 and we can't move through the lines, and nobody is using
4 it. So we want to make sure that in a development or in
5 a small town, if only half the town is platted, we want
6 to be able to hit the owners of remaining lots for their
7 share of utility power we have made available.

8 That is an extreme case, but all I can say is
9 it has already been done for other reasons, for other
10 purposes. It simply exists as a tool in response to
11 conservationism efforts.

12 SENATOR GOULD: Could they also ask to be made
13 a taxing district? Since they're already a public
14 utility in most cases, and have elected officials and are
15 really bounded by district lines, if they were given the
16 power of a taxing district it would be essentially the
17 same, I suppose.

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1 MR. APPEL: There are other statutory and
2 constitutional limitations on the amount you can tax a
3 given piece of property, and one of the things you have
4 to remember about a utility is it doesn't tax, it doesn't
5 have to have uniformity under the constitution. You can
6 enforce utility non-payment by shutting off -- if it's a
7 joint water and sewer, as an example, or electricity --
8 you can shut it off all the way. If they're conserving
9 all the power, or half the power but need the other half,
10 you can shut it off all the way.

11 It's like trying to deal with another phone
12 company when there is only one. These are monopolies
13 we're talking about. They get their strength from a
14 necessary market monopoly.

15 So my answer is, will that be given up? No.
16 We'll never permit taxation for this, it will happen a
17 different way.

18 As a person who formed storm drain utility
19 districts in state -- and I've done five of them now --
20 we now charge in many, in Bellevue, Tacoma, Vancouver,
21 Steilacoom, Clark County, those utilities now charge for
22 storm water run-off.

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1 Now, that was a service that was normally paid
2 from the budget out of taxes. That was turned into a
3 utility. And the reason for that is that is now a
4 service that will go outside. The same thing could
5 happen with police and fire protection, they could start
6 turning into utility ratings, and one by one these may
7 happen.

8 The best example I can give you is a recent
9 expansion of fire protection districts which can now have
10 local improvement districts for assessments to obtain
11 more fire-houses, which can't be raised from taxes
12 because the tax level is too high.

13 SENATOR BOTTIGER: My bill.

14 MR. APPEL: And we drafted it. But I think we
15 need to know what the implications of this process is.

16 SENATOR BOTTIGER: In the case where a
17 developer that comes into a fire district and wants to
18 build a new mobile home park and create a new fire
19 district, what we said was, "Fine. You pay for it."

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1 MR. VOGT: Bill, I think it might be useful,
2 in illustrating this a little further, to talk about the
3 kind of -- maybe by graph or verbally -- on how you get
4 into a situation where you need an availability charge in
5 terms of, you know, assumption about the elasticity of
6 demand for electricity and total revenues. Maybe that
7 might be helpful. I don't mean to steal your show but --

8 MR. APPEL: No. But incidentally, I'm not
9 trying to make this my show. I'm really here to answer
10 questions, and my presentation is really only designed to
11 anticipate questions. But to the extent I don't, please
12 ask.

13 One of the problems with a utility is that
14 while it has a monopoly, it has a monopoly on what it can
15 sell. If it can't sell it or people don't use it, it has
16 an immediate problem, and while utilities can covenant
17 under their borrowing agreements to keep rates up, they
18 still have to go through rate increase hearings one way
19 or another.

20 So there is an area for public participation,
21 but one of the problems that has come up is that
22 utilities and others are working on different assumptions
23 of what exactly, what the electrical needs are, and there
24 is a steady shift of the amount of what these needs are,
25 which depends always on assumptions.

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Because when one invests in a utility plan of this magnitude, you're really investing in energy futures. You're investing in what you think people are going to need. If they don't need it, you get no -- what Don suggests, you won't even have demand. It's perfectly possible to have either an overbuilding or an overdistribution and have no way of selling it.

And I guess the only way I can put it is that the utilities are looking for what kinds of covenants they can pass through to the bond holders, because they are essentially economic animals, and there is a term of art which is called the "come hell or high water provision," which essentially means that the utilities have to pay WPPSS whether they get the service or not. Therefore, the individual utilities are going to want their customers to pay whether they get the service or not. This is already the case in connection with sewer districts.

SENATOR BOTTIGER: The dry hole section.

1 MR. APPEL: That's right. So what you now
2 have is, and really what everybody is banking on, is that
3 you're no longer investing in the energy market at all,
4 what you're really investing in is a credit market.
5 You're looking at the credit of people whom you can tag
6 to pay for services, whether they receive those services
7 or not.

8 In that respect, with that out, these aren't
9 really utility bonds at all, because it isn't an
10 operating utility any more. What it is is a means of
11 passing through financial risk to people, whether they
12 participate in it as a utility the way you and I would
13 understand it or not. It's by that method that all real
14 rational marketing and conservation concerns are avoided,
15 ignored, they're immaterial.

16 And I don't know, Don, if that responds to you,
17 because I'm not sure that market elasticity is even the
18 point, once you've built it up into a financing creature,
19 as to whether it doesn't matter whether you get
20 electricity or not.

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1 MR. VOGT: I think that is the point, that if
2 the cost of the plants reach a point where people find it
3 cheaper to invest in conservation than to pay their
4 electric bill, then the argument would go that if their
5 electric bills go up to \$2,000 or \$3,000 a year, whatever
6 the figures show, that then the \$500 attic insulation
7 makes sense. At that point, the amount of electricity
8 they use declines, which means that if WPPSS has -- in
9 the case of WPPSS -- so much money, it has to, tries to
10 pay off the bond. It has to raise its rates on everybody
11 who is using electricity to generate the total amount of
12 revenue.

13 SENATOR GOULD: Has to get the money out of it
14 anyway.

15 SENATOR BOTTIGER: Now, that's the zero or
16 declining growth scenario. So you can raise the price so
17 high that people go back to candles.

18 MR. VOGT: Or even if they cut back, it
19 depends on --

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1 SENATOR BOTTIGER: Well, you can take anything
2 to an extreme, and I think you've approached the extreme
3 when you say there won't be any demand for that
4 electricity. With the base market you have for
5 electricity -- you're not going to close this office
6 building down. You might shut off some of the lights,
7 but there is a base market there that's inviolate, and
8 unless somebody comes up with something better like a
9 generator or a disc on the roof, that technology I think
10 is --

11 MR. APPEL: There is another aspect to it. It
12 isn't as to whether you hit the extremes or not, because
13 the world will muddle through in the middle. There could
14 be bankruptcies and people would muddle through.

15 I guess what I'm saying is that the way this
16 financing structure is designed, there is no incentive
17 ever to do anything else but to use the power, because
18 you have to pay for it anyway. And so in effect what
19 you've got is not so much getting down to zero demand,
20 but there is no reason you should get off electricity and
21 electricity only if you still have to pay for it.

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If it is for the purposes of selling electricity, as a utility, fifty percent is perfect for an electric utility because they can raise the rates to make up for it. As Don points out with his extreme example -- and I agree with it to the extent which reality would take me, which is about halfway -- is there is no reason to insulate if you're going to have pay the rates anyway. You might as well use the electricity, because you'll have to pay the same amount. And when, after an architect designs a solar building or a company decides to come into town for aluminum hot lines, which is an indication what the economics are, looking from an economic viewpoint, if you're going to pay the same rate whether you save it or waste it, why save it, unless there are federal tax credits. And that may or may not pay off. Or we're getting into another area, but what I'm saying is the way this particular system works, there is no reason to do anything else. That's all.

1 SENATOR BOTTIGER: Let me challenge that
2 remark. Clallum County PUD, which is a sole Bonneville
3 purchaser, or I could use Benton or Rural Electric or
4 Inland Power & Light, all of which are sole purchasers,
5 are forecasting two items, growth of population and,
6 therefore, demand, and in addition, price increases
7 because of the percentage purchase that they've made. If
8 I were a resident there and the price was going to go up
9 five times, and I could cut my bill by insulating with
10 thermal windows and plugging all the holes, I could cut
11 my consumption in half, then the five times price rate
12 would really only be a two and a half time increase out
13 of my pocket.

14 MR. APPEL: Maybe, and the maybe would come
15 this way. First, you have to assume that if they use
16 less power, it's going to go somewhere else, because that
17 power -- the money must be generated. It's only a
18 question of how much power that money is going to pay for.
19 If those PUD's are chargeable for a percentage interest
20 of a given generator --

21 MR. BOTTIGER: That's where I was --

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1 MR. APPEL: -- they're going to pay that
2 percentage interest, no matter what percentage they take,
3 recognizing they're going to be within their percentage
4 participation in the production plan. So what happens is
5 if my bill is going to be \$100 a month, no matter what I
6 do, why should I conserve?

7 SENATOR BOTTIGER: That's where I challenge
8 you. Your bill is going to be \$100 a month if you
9 insulate. If you don't insulate, it's going to be \$200 a
10 month.

11 MR. NEAL: Aren't you saying that they'll
12 build in the aggregate and if some of the customers
13 insulate there is going to be a constant increase --

14 SENATOR GOULD: The rate is just going to be
15 increased.

16 MR. APPEL: So the monthly bill they're going
17 to pay, if they all did insulate -- that's an extreme,
18 too, but we're trying to make a general example, which is
19 impossible. If everybody cut their power use in half,
20 the utilities only response would be to double rates,
21 because it must pay that money.

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1 This is one of those things that get
2 interesting from the individual user's standpoint, that
3 you hope enough people have missed the boat so that if
4 you conserve, you'll come out ahead and the other people
5 will bear the brunt. And if you get a heavy winter,
6 you're protected and somebody else isn't.
7 Neither example will really make it. Some will benefit
8 and some will not.

9 The only reason I'm looking at it as a whole
10 is because the PUD's credit is on the line. Some of
11 these people you're naming are our clients, and the calls
12 we get indicate that your example isn't the one they're
13 counting on. And you know, I think they've -- because it
14 isn't so extreme as waiting for all the molecules to get
15 to one end of the room. I mean it isn't that sort of
16 angle. The problem really is, now that the federal tax
17 credits are there, people do appear to be willing to make
18 some changes. And that helps everybody, except the
19 utilities have to come up with their share of the money,
20 that's all.

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SENATOR BOTTIGER: Along this line, and you may have intended to comment on it later. In analyzing the commitment percentages to purchase, I find an out of line -- I find some very small utilities that have overbought, and some larger ones whose growth rate would indicate they've underbought percentage-wise, and Snohomish County PUD is an example.

At their growth rate, their long-range supply is going to have to come from someplace else, if their growth rate continues and conservation doesn't have the effect you're describing. Whereas Benton, Rural and Inland Power & Light have overbought.

Now, I can see one by one these utilities getting in trouble because of that overpurchasing problem.

MR. APPEL: I can also see, in that case, if you get a group of utilities agreeing, I can see them reallocating percentages. I don't see any problem with that. In fact, one of the things that makes some of the solutions to the problem so workable is the rigidity with which this transaction was put together. Snohomish PUD really could buy from Klickitat PUD a block of power and it would have it.

1 SENATOR BOTTIGER: And conversely, they could
2 drive it like Puget Power and get into a retail/wholesale.
3 You don't see the problem that I see. That was one that
4 concerned me.

5 MR. APPEL: We're all guessing with questions
6 of likelihood, but there is another aspect to this. One
7 of the advantages of being a utility is that if you have
8 a problem, you can always run and get regulated.

9 And for instance. I believe it's Puget Power,
10 John Ellis went to the commission and got more relief
11 than he asked for, but he got relief.

12 And one of the problems is that utilities
13 really do not know, and I've had extensive discussions
14 with Seattle City Light, as to how much power a given
15 customer is entitled when he links on the line. Nobody
16 knows what the legal obligation of a utility is to supply
17 somebody who is connected. So utilities, when they ask
18 their lawyers, here is what we've connected, how much
19 power do we have to have? Nobody knows.

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1 SENATOR GOULD: Isn't the other problem
2 related to this whole thing that you don't really know
3 how much conservation will do for us, either? We don't
4 really know what people will do as far as conservation is
5 concerned, and to say that maybe half in any single
6 utility will be conserved through insulation or other
7 methods is really probably more than anybody could hope
8 for, particularly in a growing area.

9 MR. APPEL: Well, it's hard to tell. I was at
10 a Tacoma city council meeting when the Bonneville seven
11 year notice of uninterrupted service was read. At that
12 point, seven years later Tacoma goes uninterrupted from
13 Bonneville. I forget how many years ago it was that
14 letter was read.

15 There wasn't a ripple there. Nobody was
16 concerned. That's seven years, the whole city council
17 was going to be replaced by then.

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1 So one of the things I think is very important
2 is what is your real time line? Every question has
3 several answers, depending on which time line you're
4 considering, and also which hat you're wearing. As a
5 utility user, as an official of the utility two years
6 from retirement, as a person whose election comes up next
7 year, as a person who is running, as a person who is not
8 running. These are all considerations, is really what is
9 the rest of the world going to look like.

10 All I can say is, in 1957 or before that -- I
11 guess about then when Sputnik went up -- until that
12 happened, no one believed that anything going around the
13 world in space had any validity. It was all science
14 fiction.

15 And then it happened, and I have myself never
16 recovered, not from Sputnik, but from watching the people
17 around me who two days earlier said it was pie in the sky --
18 no pun intended -- and the next day said not only is it
19 real, but we've got to have one.

20 And that was so fast it happened, people by
21 the millions, and then Kennedy, \$20 million going to the
22 moon. That was when \$20 million would build four dome
23 stadiums then. That's how I measure \$20 million. But
24 the one thing you cannot bank on, and no one can, is what
25 people will do.

1 What I have to keep coming back to in this
2 transaction is this transaction is designed to make sure
3 that the investors will get paid, no matter what people
4 do. And that's why it's so difficult to do incentive
5 planning when there is no incentive to conserve, no
6 incentive to have planning, no incentive to turn them on
7 or off. Because to the investor, it doesn't matter
8 whether those things ever get, those things filed on the
9 financing, ever get completed. It's totally divorced
10 from the financing of a normal business.

11 SENATOR BOTTIGER: I ought to send in my
12 letters between me and Inland Power & Light Company.

13 MR. APPEL: Not all utilities have this deal,
14 and what we're talking about is not utilities, it's WPPSS.
15 And WPPSS is a consortium, it's not a utility. That's
16 what we have to remember. Everybody thinks WPPSS is a
17 utility, it's not.

18 SENATOR BOTTIGER: It's a municipal
19 corporation.

20 MR. APPEL: By the same way a lot of colleges
21 were named universities by the legislature. It's
22 whatever the legislature calls it.

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1 MR. NEAL: That raises the question, there
2 have been some recent Wall Street Journal articles about
3 WPPSS bonds and portfolios and that sort of thing. If
4 investors absolutely understand that, it doesn't matter
5 if the plants are built or if they ever produce or there
6 is no motive to conserve or anything else. That if the
7 investors are pretty well insulated or insured or however
8 you want to put it, wouldn't that assure a market for
9 WPPSS bonds at any given time, if that's widely
10 understood?

11 MR. APPEL: Well, of course it does. WPPSS is
12 the largest issuer in the United States, excepting for
13 the United States of America. It is larger than the
14 State of California, it is larger than anything. There
15 is a book that came out on the market by McGraw Hill just
16 a few days ago -- it's good up through 1978 -- and it
17 talks about the large power consortiums. But it does
18 notice at the moment WPPSS seems to be the largest.
19 WPPSS has outstripped everybody else.

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1 Now, the fact that a credit is good doesn't
2 mean that it is a wise or lawful investment. This has to
3 do with simply rules dealing with investment. When
4 you're dealing with a portfolio of this size of pension
5 funds, insurance companies, banks, you're dealing with
6 restrictions on, no matter what it is, how much they can
7 put in any one investment. And that's why you're going
8 to find, you'll find that portfolio managers say, 'We
9 have all we can take of WPPSS.'

10 And the response might be, "But it's so good,
11 how can you not take more?"

12 And the answer is, in some cases the law
13 restricts how much they can hold. For instance, national
14 banks can hold no more than a certain percentage of a
15 given obligation. One of the aspects about a pension
16 fund and trusts are they have to follow laws and
17 standards on the common law as to how much, how many eggs,
18 you can put in one basket.

19 And if in 1912 you invested in buggy whips
20 because the credit was spectacular and Henry Ford went
21 forward, those are the banks that all got sued for
22 failure to invest wisely. It didn't mean the credit
23 wasn't good.

24 There are other possibilities. This has to do
25 with the secondary market I discussed. What would happen

1 if there was a scandal in WPPSS, some meetings somewhere,
2 and it got in the Wall Street Journal? What happens to
3 the secondary market? Investors say, 'I don't want those.'
4 They don't know the truth or falsity of those things.
5 The conversation doesn't take more than 40 seconds.
6 Remember that 40 second conversation? Because it is the
7 sole human, window of human feelings that influences
8 these market discussions.

9 If there were a scandal, what happens is
10 secondary buyers, trust officers say, "I know there is
11 something going on there. I don't know what's happening."

12 So the Florida banks decide, until things cool
13 off or it's resolved or people forget or whatever,
14 they're going to buy less. What happens when that
15 happens is the secondary market begins to disappear, and
16 the underwriters face a difficult time selling because of
17 those 40 second conversations, because that's where its
18 sales people have to sell.

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1 Now, I'm not concerned in talking with you
2 about whether what happened is actually true. We don't
3 know what happened. We don't know what happened at WPPSS
4 that started a rumor or who started it or what the facts
5 are. All I know of is once a rumor gets out in the
6 market, it's a dangerous situation. And it's a dangerous
7 situation which is not the same with the municipal bonds.
8 The fact that the municipal bonds market is ten times the
9 corporate bonds market in the United States doesn't phase
10 anybody, because there are peculiar legal restrictions to
11 what the SEC could do in the case of, any regulation of
12 marketing is the only way I can put it. I will also say
13 that the purchase agreements generally, and the public
14 offering statements, generally say that you bid on these
15 bonds provided not that market conditions remain the same,
16 but the condition of WPPSS remains the same. And if
17 WPPSS suffers a change in credit or something serious
18 happens, the buyer of the bonds can also back out. That
19 is, before they're picked up, the day of closing. That's
20 a fairly short period of time, never longer than six
21 weeks.

22 SENATOR GOULD: What would the shut-down of
23 one plant cost them? Suppose it was decided, as some
24 people suggested, that we shut down five or five not be
25 built.

1 MR. APPEL: Well, since I'm not an underwriter
2 but I deal with them all the time, whatever I have to say
3 is impressions from underwriters. Obviously, it would be
4 more serious if it were four and five than if it were one
5 of the early ones that are backed up by Bonneville. I
6 think what would happen is that there would be an
7 addendum to one of these, it would simply say that, let's
8 see, this is nuclear projects four and five, nuclear
9 project X is not going to be constructed, but the credit
10 is unaffected because the utilities are equally on the
11 line. And whether the power is available or not has
12 nothing to do with it, because the rate structures are
13 independent. In other words, it's an item that would
14 have to be explained. It is a material fact. And my
15 guess is there would be a bump in the market, but I think
16 it would come back up. The investability doesn't change.
17 The investment quality doesn't change. The same credit
18 is on the line. The only time it would matter is if
19 those utilities had to have that power in order to pay
20 those bonds, but they don't.

21 SENATOR GOULD: But you were talking about a
22 scandal, and I would assume that one not going on line or
23 one being shut down would make people nervous.

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1 MR. APPEL: I don't think so, because the
2 scandal I'm talking about is really what would be related
3 to investor confidence in the bonds, because that's
4 really what you're selling is investor confidence. But
5 if they said, "We now know better, but all the bills will
6 be paid, by the consortium" -- the way an insurance
7 company would say, "We now have a loss, we're going to
8 pay it," nothing would change.

9 The fact is that the investment community --
10 except under the 40 second conversations where it's
11 simplified to the point where it's a cartoon -- at the
12 underwriting level they know that the credit is
13 unaffected. They know that the likelihood of actually
14 receiving power is quite a ways down down the pike, and
15 they're not even selling the bonds on the basis of
16 generating power. They say they will because that's what
17 it's supposed to do, but it's not a bond covenant. There
18 is no bond covenant to the bond holders that these
19 projects will ever be completed. It doesn't matter if
20 they are.

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1 SENATOR GOULD: What would happen if we shut
2 down one and then Puget Power started building? What
3 would happen to their credit line? Or if they had
4 started building and issuing bonds and we shut down,
5 WPPSS shut down one. Would that have an effect on the
6 private market?

7 MR. APPEL: Probably not, for the same reason.
8 It would depend on whether Puget Power's ability to pay
9 depended on whether it got that power or not, which this
10 doesn't appear to be. Then it wouldn't matter. What it
11 would be would be a workout of sorts.

12 But in terms of the investment quality of the
13 bonds, do you know, as looking at WPPSS alone, the fact
14 that there would be no more WPPSS bonds -- I'm speaking
15 wildly and hypothetically -- might for a brief period
16 enhance the marketability of those bonds. Because one of
17 the problems WPPSS has is every bond holder knows that
18 they're just coming out every couple of months in \$200
19 million floods.

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1 If you stopped issuing them, it would be a
2 clear tax credit. And the credit is those bottom line
3 utilities pay dollars that are marketed again and again.
4 If they stopped doing that, then every bond holder would
5 know that they're not going to order down that credit
6 again, that market is secured, which is the only real
7 security these things have. Excepting for Bonneville,
8 which of course looks to the same utilities payable. I'm
9 giving you probably an untypical response.

10 SENNATOR BOTTIGER: The scandal that you're
11 talking about would fall in the class of a state
12 appellate court decision that Seattle City Light could
13 get out of -- for some reason Seattle City Light's
14 commitment is voided.

15 MR. APPEL: Let's talk about that when we go
16 off the record. But my guess is the scandal would be
17 something that people understand, like dishonesty, like
18 somebody going to jail. Remember again, I'm talking now
19 about the marketability of bonds. The marketability of
20 the bonds is tested in how you can sell them, and the
21 actual sale of bonds occurs in these very short
22 conversations.

23 MR. VOGT: You might explain those a little
24 more.

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1 SENATOR BUTTIGER: You're talking about the
2 foreman of the subcontractor firm or are you talking
3 about the assistant manager of --

4 MR. APPEL: I'm hypothesizing. One of the
5 managers of WPPSS turns out to be indicted for forgery.
6 It would be that simple-minded because again it has
7 nothing to do with what the facts are or how they relate.
8 The way that "Washington" appears at the head of the bond,
9 that's all you need to affect marketability. Every step
10 beyond that is story bond. You get no interest, you're
11 now talking in a pawn shop. You're negotiating.

12 MR. NEAL: Are you talking about the scandal
13 occurring in the actual underwriting?

14 MR. APPEL: Or thereafter. Let's suppose the
15 bonds are sold and a scandal comes out. What WPPSS then
16 knows is the next \$200 million issuing may have to be
17 sold quietly on a short term to banks until the market
18 furor dies down, because they know when they sell to the
19 underwriter they don't want to commit to a long term.

20 MR. VOGT: Why don't you expand very quickly
21 on how these are sold in the, you mentioned the 40 second
22 conversation.

23 MR. APPEL: Basically, it occurs -- in the
24 first place, the offer to sell can only occur when the
25 underwriter has reason to believe that it will control an

1 issue of bonds. In some others, it's very competitive
2 and some several underwriters will be competing for the
3 same thing, and their sales people will be calling the
4 same accounts. Let's look at the different -- this also
5 has to do with how they're sold, what is sold, what they
6 have to sell.

7 Let's look at -- since this gets us into the
8 balance financing -- let's look at what a bond issue
9 really consists of. In other words, who buys? What are
10 we talking about when these sales are made? Who are the
11 buyers of these sales?

12 Well, I won't use a normal utility. I'll go
13 right to WPPSS. What is WPPSS' market? It has a whole
14 lot of bonds that are already outstanding, and again it's
15 not an operating utility. So basically what it is
16 shooting for is level debt services, something like that,
17 principle and interest from 1980 to 2050. I'm going out
18 to 2050, but they'll be there soon, so I might as well
19 use it.

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1 An individual issue of bonds is going to
2 consist of a series of dated maturities, and you see them
3 right here. This is principle and interest that they pay
4 every year. And let's take a bond issue of, it doesn't
5 matter how many dollars they are, but let's say that they
6 mature approximately evenly. Let's see how this would
7 work for a given issue.

8 Now, the reason it's scaled that way is for a
9 couple of reasons. One is that on a given issue, as they
10 pay off principle amounts, the interest goes down, so
11 they're maturing more principles each year. That is one
12 way you would get approximate level debt service from a
13 single issue. Actually, they generate a tremendous
14 amount of expiration which requires a computer to keep
15 track of them. But let's look for the moment -- this is
16 1990, and so let's look at the bonds that mature between
17 1980 and 1990.

18 Now, basically you're looking at investors who
19 want not only tax exempt interest, because that's an
20 assumed for the whole thing, but who are looking for
21 fairly early maturity. They're looking for portfolio
22 equity of maturity type.

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1 That is, they are not going to market the bonds.
2 they're not going to resell the bonds, they're going to
3 hold them, put them in at maturity and their cash flow
4 needs are scaled for when those bonds mature. So they're
5 pretty short term.

6 And the people who might buy those bonds, as
7 an example, are trusts for people that aren't 18 yet, but
8 they're eight now and they'll be 18 in 1990. And they
9 might buy a block of ten bonds, put them away and let
10 them mature.

11 Basically, it's not a very active market. On
12 some levels you will -- there are some peculiar features.
13 Underwriters will sell quite a lot for some reason in
14 some areas where people make their money very quickly in
15 a given transaction, because they mature so quickly.

16 SENATOR BOTTIGER: So guess that would also be,
17 in even shorter terms, that would be somebody who has
18 some money, where the state will sell a bond issue, then
19 reinvest it and pay out highway construction projects as
20 the payments come due?

21 MR. APPEL: Well, the state can do better than
22 that, because what the state will invest in is high
23 interest rate tax certificates for governments, for
24 different reasons.

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1 But what you're talking about is the same or
2 approximate for maturities that are even shorter than
3 this. It's the same idea, people have a short term
4 investment goal, they're going to get in and get out.

5 SENATOR GOULD: Are you talking about people
6 who are ten years from retirement and want a high income
7 with no tax?

8 MR. APPEL: It may be. Now there are
9 individual tax shelters under KEOGH's and IRA's, but this
10 is what they used to do. Another might be a national
11 bank, which under the National Banking Act has a certain
12 percentage of their earned capital and surplus that can
13 be placed in certain types of investments, that money.
14 And, of course, they assume that either they take a
15 market risk and they have to sell in order to liquidate --
16 and they don't want to do that, because national banks
17 don't want to take market risks -- or they get fairly
18 short term payments that they're going to get paid on.
19 because they can't take a risk. If they wait for
20 maturity and get paid off, this is a fairly safe tax
21 exempt investment, but short term.

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1 At the far end you get another quality. We
2 get people who are interested in the paper for its market
3 purpose alone. And these people are going to buy a bond
4 in 2000, the maturity is from 2010 on. Because they're
5 saying, "Right now what I want is a piece of paper. I
6 don't ever want to have it mature on me. I want to have
7 it as a market investment. I think nine and
8 three-quarters is an excellent rate, and I think if I
9 hold it for eighteen months I can resell it for capital
10 gains, because I think interest rates are going to go
11 down and I'm going to get a premium whenever I sell my
12 bond. I don't want the buyer of that bond to say, 'But
13 it matures in 18 months. I'm not going to pay you a
14 premium.' I want a bond that would have a consistent
15 market for years and years and years."

16 So that's what this group is. You'll find
17 that this whole group can be found in the term bond.
18 You'll notice here they have, for this issue to be issued
19 in 1980, or which was issued in 1980, you have a series
20 of term bonds in 2004, 2012 and 2018. These are people
21 that want to know that in these years those bonds aren't
22 going to be paid until then.

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1 Now, there is a wrinkle, because if they have
2 to pay all those bonds in those years, look what it does
3 to your debt service. So what they do usually is to have
4 a kind of lottery. What they do now is to have --

5 MR. VOGT: Talking about WPPSS now.

6 MR. APPEL: WPPSS does or the bond issuers
7 have a kind of lottery. What they do is say, 'We're
8 going to start putting aside money to pay these bonds in
9 the intervening years when they're not otherwise due, and
10 we will call some of those bonds in the intervening years
11 and we'll call them by lot."

12 The investors that hold those bonds have no
13 idea whether they have bonds that are going to be called
14 at the very end, whether the bonds state its maturity or
15 one of intervening years, whether they can call that bond
16 by lot, as an example. So the investor is blithely
17 unaware, except the investor knows as a random risk that
18 that bond might be called.

19 The whole market takes that random risk for
20 these so-called term bonds and says "I don't know, either."

21 So the buyer and the seller of the bonds,
22 dealing with those bonds, have an equal chance that the
23 bonds will or will not be called in that given year.
24 They have no idea.

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1 So the marketability of those bonds in the
2 market at this level of years is preserved, and the
3 utility gets to call these bonds just as though they were
4 maturing every year. Actually they are, but nobody knows
5 which bond is going to be called. but they will be
6 called.

7 SENATOR BOTTIGER: On refinancing; if the
8 interest were to drop, can they then escalate the
9 percentage number that can be called?

10 MR. APPEL: They can. There are two types of
11 call provisions. One is the optional call, which is what
12 you're talking about. Usually there is a premium or a
13 penalty to prepay, and all I can say is in some issues,
14 yes, there is almost no -- usually for the first ten
15 years there is no call at all. That happens to be a very
16 common marketing device right now.

17 And the bonds that go out into these regions
18 here, these maturities past 1990, as an example, can be
19 called, but for a shortening period -- out for about 10
20 years, 10 1/2 years, or 15 years, beyond which they can call
21 them. There may or may not be an incentive to call them,
22 but that's right, they often have called them. That's
23 what I'm talking about here -- what we call a voluntary
24 call, which is the market's call.

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1 Now, out here really is the classic zone of
2 maturity, and basically these are -- it's really kind of
3 a mixture of bank and trust companies and there sort of
4 is a market trade. But they also tend to look at the
5 maturity to see, if they wanted to get out, how close to
6 maturity would the bond be when they get out. But as you
7 know, if the bond is going to mature tomorrow, I can sell
8 at a premium. All I'm going to get is that cash.

9 Now, instead of looking at it as a single
10 issue. looking at it as a total issue, because you're
11 dealing with the general public here and the more
12 sophisticated market investors here and the banks and
13 trust companies, national banks here, you're really
14 looking at three different markets. So what happens is
15 when they say, "Look, the long range maturities are
16 full," it is saying that the bonds maturing way out here
17 have really taken up about the share of the market before
18 it becomes kind of economically embarrassing. They
19 simply can't sell more.

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1 The trust companies that hold, that are
2 willing to take a market risk out in here, now have the
3 percentage of bonds which they can have without some
4 contingency of liability, that they simply have too much
5 of a single investment in their portfolio. When you're
6 talking about an issuer that issues \$500 million every
7 four years or a million every four months, you're talking
8 about a tremendous amount of this paper.

9 MR. VOGT: Bill, I don't think the senators
10 have had a chance, unless they've done it independently,
11 to understand about the WPPSS study that points this
12 problem out. You might show them the volume here. WPPSS
13 has their own financial advisors, the hard cover volume
14 analyzed their market for their bonds, and has issued a
15 report. That one there. Yes, the blue one. Has issued
16 a report which had raised this as a problem.

17 MR. APPEL: What they're pointing out is, and
18 here is what they propose as their solution to it, and
19 all I'm doing is taking you very quickly through what it
20 is that's going on behind these.

21 MR. VOGT: I guess the basic point is that the
22 traditional sources of funds that far out are getting to
23 the point where they do not want to acquire further WPPSS
24 bonds under the prevailing market.

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MR. APPEL: They're encountering market resistance.

SENATOR GOULD: Running out of investors.

MR. APPEL: That's right. But not because it's a bad investment, you see. What we're talking about now has nothing to do with the investment quality, and this is the one thing that success cannot handle. This is the one thing that a brilliant financing scheme, which this is, cannot take into account. It has grown too big for its market.

So what they have to do is to say, "Where is there room for us?" We will expand our debts, because that's what the business of WPPSS is, construction and debts. That's their only business at the moment. We will expand our paper into that market. And what they've discovered in looking at the market and talking to their underwriters and financial advisors is that the short term zone is, most of their bonds really mature something like this.

(Discussion off the record.)

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MR. APPEL: Basically what happened here is that WPPSS has discovered that the market is saturated for these maturities, but is not yet satisfied for these maturities for WPPSS obligations. So they're saying in effect not, "Let's saturate the market," but "We can't sell any more any other place. Here's where we can incur more debt."

I don't mean to say that they're in the business of incurring debt. They've got some contractors to pay. But this means they want to issue short term obligations to even out this line, and they're pointing out in their cartoons here how simple it is. This one is green line, sir, this is the area they're shooting for.

The only thing I think you have to think about it is that WPPSS is an unusual animal. It's unusual because sooner or later this debt is going to have to be paid in cash, which is what usually is done when either it's an unpleasant market you want to skip and avoid or you've got an early retirement coming and you're not going to worry about it.

1 And this is a dynamic I've certainly seen in
2 city councils, is that you issue short term debt and
3 you're not around. You're not around in 1988 when rates
4 have to do something incredible, because you're now
5 between here and here, in order to pick up short term
6 debt. Which in the normal spheres of capitalization, you
7 normally make your debt last the life of equipment. It
8 should have been out here, but they can't sell out there.

9 So what they're going to do is to incur a
10 short-term obligation for a long-term acquisition, which
11 is the reverse of the normal way. One would try to get a
12 long term obligation for anything they can, stretch out
13 the payments. Here they're going to shorten out the
14 payments.

15 SENATOR BOTTIGER: We'll have to refinance
16 when those come due.

17 MR. APPEL: We'll have to refinance, but the
18 results of refinancing will be, they hope -- this is the
19 gamble of the scheme -- they hope when they refinance
20 they're going to put the maturity out here, because you
21 know where they'll put them if they can't. They're going
22 to issue another series of short term paper, because
23 nobody is buying the long-term stuff.

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1 And that can happen in a period of time of
2 sufficient economic instability where people simply
3 aren't buying long-term papers, and this hits and not hits
4 like a drum beat. About every four years in our economy
5 people stop and look and people are saying "Hey, why
6 should I talk about your 20/50 dollars? I don't even
7 know what they're going to be worth."

8 So what they have to do is, they're forced
9 into the market risk to say, "Maybe it's 20/50 dollars,
10 but the interest is good. I'll take a market risk and
11 see if I can sell at a profit, because at my age I would
12 like to see 20/50, but the odds aren't high. I'm not
13 going to hold to maturity, I'm going to take a market
14 risk.

15 So that's why these bonds or theater notes or
16 whatever you want to call them are completely different
17 from these.

18 Now, in the bond world, these are basically
19 probably what are called BANS, bond anticipation notes.
20 They'll look like bonds, they're going to say bonds on
21 them, but the underwriter knows they're issuing debt
22 that's probably going to be thrown out as far as they
23 possibly can. They'll be thrown out as far as they can
24 until people won't buy any more.

25

1 At that point, they'll try to structure an
2 issue like that and allow, and keep the rates as
3 politically as possible, because one thing WPPSS knows is
4 that they don't want problems. If they have problems,
5 where the utilities have to pay, that becomes public and
6 it affects the emotional marketability of these bonds.
7 Even though, as I explained, the credit is rock solid.
8 But it's those 40 second conversations, the 40 second
9 conversations where these sales people say, "Want to buy
10 some short term bonds?"

11 "Short term? Didn't even know they existed.
12 Sure."

13 If the credit is good, that will work for
14 awhile.

15 The problem is what happens when the piper has
16 to be paid. So basically the risk that is being taken
17 here is one of two things, the political risk of very
18 high, much higher increase in rates passed through to
19 consumers or, hopefully, they'll get out into this, that
20 zone out here, this heaven out here.

21 They can see they don't have to worry for long.
22 It's past my generation, your generation, and the rule of
23 world is nobody has to bother with the -- I've heard
24 underwriters saying, "I won't even be alive when that
25 matures."

1 That's not the sort of thing that enhances the
2 appearance of responsibility, but there is an aspect of
3 this that I think is important. All debt financial
4 schemes work better in an inflationary period. It's a
5 debtor economy, and WPPSS is a massive debtor. And this
6 entire thing will go along just fine so long as the
7 economy continues to be inflationary. We're talking
8 about a pretty substantial period of time, and that debt
9 is being made, and I can't say anything more than that.
10 Because every human being has to guess and it's a human
11 guess as to what might happen here.

12 And here again, people have to be employed.
13 have to consider am I still employed? Am I in office?
14 Am I running? Am I not running? They're all
15 considerations. They're human considerations, and it's
16 human considerations which underly this whole thing.
17 Which, speaking as a lawyer, if I were an investor I
18 wouldn't worry. Speaking as a person who has got to pay
19 Seattle utilities, I have to stop and think as to what
20 Seattle will be like for industry which is what
21 ultimately keeps me in business.

22 So there are a tremendous number of thrusts
23 operating here, and all I can say is the balance
24 financing plan is a very simple way of looking at the
25 graph and saying, "This is unbalanced, let's balance it."

1 SENATOR BOTTIGER: Let me ask you, there is
2 another possibility, and it's almost heresy to say this,
3 but what about construction work in progress? What about
4 sticking it in the right place now, being on a current
5 basis?

6 MR. APPEL: Well, when you say what about
7 doing it, the answer is that they can -- you mean pay it
8 out as current expenses?

9 SENATOR BOTTIGER: Well, raise rates now, and
10 use cash instead of bond debt.

11 SENATOR GOULD: For the construction?

12 SENATOR BOTTIGER: Yes.

13 MR. APPEL: Now, that is what utilities
14 themselves cannot do, as I explained, unless they've got
15 something to sell. Here the utilities which are at the
16 base of this pyramid do have something to sell, and yes
17 they could pay the entire thing out of current cash. The
18 last several years, the city of Aberdeen, which happens
19 to be a client of ours, was playing with the thought of
20 that, what would happen if we paid it out? What would
21 happen if we paid out like the debt of every person in
22 the United States? What would happen if we paid it off
23 per household?

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1 Aberdeen two years ago, it was \$15,000. Now
2 it's Aberdeen's share, and I don't remember how many they
3 signed on. But that was their share. So realistically,
4 whatever it is that has to be amortized, you end up with
5 a load that really is too high.

6 That brings me to one thing about how you look
7 at number --

8 SENATOR BOTTIGER: Before you get away from
9 that, we're looking at a balance and we're looking at a
10 lot of pieces in a method of financing. If we just went
11 through a 25 percent Bonneville, 25 percent retail
12 increase, we've got some more coming, what if that
13 increase were 40 instead of 25, and that a portion of the
14 current construction costs was assessed to each owner?

15 MR. APPEL: I think what went through my head
16 didn't come out my mouth. In answer to your question,
17 what would happen living in Seattle is that the members
18 of the consortium of WPPSS would probably not permit that
19 to happen, because too many of them are themselves parts
20 of independently elected bodies.

21 SENATOR BOTTIGER: The problem is that they
22 are a municipal corporation subject to whatever laws we
23 pass.

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1 MR. VOGT: You mean if you told them they had
2 to do it?

3 SENATOR GOULD: Yes.

4 SENATOR BOTTIGER: If I want to get the
5 attention of those 23 members and get them to board
6 meetings, there are a few things we can do.

7 MR. APPEL: It would probably take that to do
8 it, because right now it is being ducked by every
9 municipality that I've talked to, and I've talked to
10 quite a few. We represent quite a few. Not because it's
11 on this subject, but what it is is they actually feel
12 helpless.

13 In the first place, they're pulling in
14 different ways. Some have hydro-power, some don't, some
15 have other sources of power. There has been essentially
16 no real unanimity on the panel. While the legislature
17 could force something, I can only suggest that if the
18 legislature does force something, does force the
19 financing while we're all in the middle of things, as the
20 Greeks say, there is a question in my mind as to whether
21 the legislature is creating, taking an act which might
22 arguably result in any responsibility on the state. See,
23 you're going beyond what I would say is the normal police
24 power regulation when you're telling them how they have
25 to pay them. There may be a way to disguise it.

1 SENATOR BOTTIGER: They need a statute to pass
2 this. We've already started talking about it. They need
3 legislation.

4 MR. APPEL: All I can say is if I were the
5 attorney general, I would say before the state does any
6 more than enable, that is permits, before the state
7 exerts any affirmative control in the middle of a
8 financing of this magnitude, the state would probably
9 want to take a look at whether the state has any
10 liability on it.

11 SENATOR BOTTIGER: That's a lawyer's thinking.

12 MR. APPEL: On two counts. One is because of
13 control generally, and second, to make absolutely certain
14 that nothing the state did affected any of the existing
15 rights of existing bond holders. Because of the
16 peculiarity of these bonds, as I mentioned, because there
17 is -- remember how you have the hotel, there are a lot of
18 promissory notes and one mortgage. You want to make sure
19 they all have a first mortgage, and legislation following
20 these resolutions may or may not be effective, depending
21 on what it does. All I can say is it would have to be
22 looked at pretty carefully. I'm not saying no, but I'm
23 just saying it is a tricky question.

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1 MR. VOGT: Bill, I think maybe one of the
2 things that sort of heightens the point about state
3 control is if you saturate the long-term bond market and
4 go to the short term, you're betting that you can bail
5 that out when these come due.

6 MR. APPEL: That's right. You'll have to
7 throw them down here when you do.

8 MR. VOGT: The question is at some point, if
9 you can't do that, and for some reason you get into this
10 electric, you know, worse case or whatever happens, for
11 whatever reason the financial market isn't there to pick
12 those bonds out, presumably someone is going to look to
13 tag somebody with the payout to have that money that's
14 coming due.

15 And I guess you're saying it's to the extent
16 that the state implicates itself in telling WPPSS what to
17 do, it may give some -- the court could tag you and say,
18 "You've directed them enough or taken over their affairs
19 enough, we are going to stick you with the bill."
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1 MR. APPEL: Yes, there is a legal-political
2 question. The Washington Supreme Court probably has one
3 of the tightest rules in the nation about what you can do
4 in terms of legislation and outstanding contractual
5 obligations. It gives the legislature the least possible
6 authority to make any adjustments, even though they might
7 be minimal or something.

8 It happened because of a court reporter slip,
9 when somebody testified that it would make the bonds
10 "worth less," and it came out typed 'worthless.' When
11 the Supreme Court saw "worthless," they said that
12 testimony was never controverted, so the law is now based
13 on that slip. But in any event, that's the law because
14 that's the way the Supreme Court saw it. Because when it
15 got to them, that's what it said.

16 SENATOR GOULD: Undoubtedly, this could be
17 challenged.

18 MR. APPEL: Yes, that's the other issue. What
19 do you do when the basis of sale depends on there being
20 no legislation? In the forming of drainage utilities for
21 Bellevue, we have had five lawsuits. On King County ag
22 bonds, we've had three. One is still pending, maybe two.
23 The bonds were sold last March. All I can say is it's --

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1 SENATOR BOTTIGER: It's almost automatic, you
2 go to court, you get it approved, they set up a friendly
3 lawsuit.

4 MR. APPEL: Yes, if you do it right. It's not
5 as easy as it was. The Longview decision was a friendly
6 lawsuit, and the court held the bonds invalid. That's
7 why we can't have industrial development bonds, is this
8 case. That was a very friendly lawsuit, one of the
9 prosecutors got interested in it, and it's one of the
10 dynamics one can't control. It's rolling the dice.

11 I'm just saying under the police power of the
12 state, I think something could be done, but I think you
13 would have to make absolutely certain that it was either
14 permissive without affecting the bondholders' rights or a
15 clear exercise of police power.

16 SENATOR BOTTIGER: In any financing scheme,
17 and getting it back to the simplified form, what we're
18 really talking about is the down payment. You're going
19 to mortgage this system over a period of years, what are
20 you paying down? And as we're going now, it's total debt.

21 MR. APPEL: There is no equity.

22 SENATOR BOTTIGER: With the exception of the
23 private utilities, which are paying their share on four
24 and five as the bill comes due, because they're stuck
25 with it.

1 My question would really be, why don't we
2 assess to the public the down payments as they're due for
3 construction work?

4 MR. APPEL: I imagine that could have been
5 done and all the private utilities would have issued
6 their bonds as Puget Power has done it.

7 SENATOR BOTTIGER: They're doing 20/80.

8 MR. APPEL: Is that the ratio?

9 SENATOR BOTTIGER: I believe so. Is that
10 correct? That's what somebody told me.

11 MR. VOGT: Yes, that is correct. That was
12 that memo that the private utilities share. Typically,
13 the way they raise capital generally is 20 percent equity,
14 80 percent debt. So presumably their share of WPPSS is
15 just dumped in out of that pot. It's a mix of 20 percent
16 equity, 80 percent debt. But I think what Bill is
17 suggesting is if you did that, rather than raise the
18 rates, you just have the local PUD borrow the money
19 directly.

20 MR. APPEL: They go to the bond market.

21 SENATOR GOULD: For the equity.

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1 MR. APPEL: Yes, for their cash. Because they
2 probably wouldn't have, the City of Seattle probably
3 couldn't get a rate raise sufficient to make any serious
4 movement in this part of this curve right now. It would,
5 considering what it's been through all summer and now has
6 an appeal pending -- I've been consulted by about five
7 groups, which means it could be -- as I understand, it's
8 already subject to litigation.

9 SENATOR GOULD: Wouldn't it be possible to do
10 the same thing, then, on the WPPSS bonds? If the market
11 is "saturated with WPPSS bonds," wouldn't it be possible
12 to go back to the PUD's, have them take over some of the
13 bonding capacity and issue bonds, because it's a
14 different issuance? It's a different group.

15 MR. APPEL: They could. It's interesting that
16 the individual utilities could -- in theory, the members
17 of WPPSS could refund all of the WPPSS bonds. It's their
18 credit. There is nothing unconstitutional about it. One
19 municipality can pay another municipality's debt if the
20 legislature permits. And Seattle, to the extent it's on
21 one and two or whatever it is, literally may, through a
22 City Light issue -- if it bought out and terminated --
23 could buy its way out of WPPSS debt, and that would be
24 the end of those WPPSS bonds.

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1 Then, of course, the next process would be
2 that WPPSS would start issuing bonds, of course. And
3 that's the way that it goes. It's really a question of
4 what is going to happen if a contractor's obligations are
5 going to continue to be incurred, because as long as
6 there are, there will be a way to pay them. As I say,
7 availability charges, individual members issuing bonds,
8 you can call it an equity, but it will end up being debt,
9 because the individual utilities financing plan cannot
10 support that kind of a cash payment. They're debt-
11 supported, too. They don't have equity.

12 Do people have any other questions before we
13 discuss another element?

14 SENATOR BOTTIGER: You mean it gets worse?

15 MR. APPEL: No. I want to talk about
16 solutions.

17 SENATOR BOTTIGER: That's what we want.

18 MR. VOGT: Let me just go through our notes
19 from when we talked. Jim, do you have anything? When we
20 met with Bill the other day, he covered all the same
21 points as he did here.

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1 Bill, one thing that I just thought I would
2 mention, you talked about the 40 second sale. Was that,
3 most of these bonds apparently are sold over the phone
4 all over the country, and you have bond trading rooms and
5 that's where this 40 second conversation goes on.

6 MR. APPEL: If you talk to a bond trader --
7 one happens to be a friend of mine who works for Rainier
8 bank -- if you looked at her you would think she was a
9 telephone operator out of, sort of a mixture between
10 Norman Rockwell showing the telephone operator and the
11 space age, because it's all push buttons.

12 What she has are push buttons that connect her
13 everywhere in the town with all the other bond traders.
14 You just push the button and you're on them, unless
15 they're busy. And that's all they do is talk to each
16 other. All of them look at immense boards by the phones.
17 They've got all the bonds that are issued, what banks,
18 bond terms or what each bank has to sell, what that bank
19 wants to buy. And it's all over the phone, it's all oral.

20 I might add that international transactions it
21 works the same way, only with billions of dollars. And
22 it's over the phone and there is nothing in writing. And
23 it's the way the market works. And the reason is the
24 market breaks too fast, people don't have time to discuss
25 things any further than that.

1 There is a higher level in the big
2 negotiations where some of these conversations take place
3 between brokers or between dealers or between banks. And
4 then you have at a much lower level an underwriting
5 office which has a sales room where the sales people are
6 making their pitches. The broker for that underwriter
7 may have already committed five percent of that bond
8 issue, half a point, and now its sales people will be
9 talking to individual sales people, trust officers or
10 individual people they'll call.

11 Sometimes I'll get a call, and it's very short,
12 very short conversation. Those people have a little more
13 time to talk, because that underwriter has already made
14 his deal and he's going to tell you what his terms are.
15 There is not a lot of negotiation going on at that level.

16 The real negotiation takes place in the middle
17 ranks where the underwriters are either about to make a
18 deal or have made a deal, and they're talking to other
19 people who are capable of underwriting, and that happens
20 very fast. They may take longer, but the longer the
21 conversation, the more leery people get.

22 MR. ZIMMERMAN: The greater the interest rate.
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1 MR. APPEL: Or "no deal" or "we'll look at it"
2 or "send me something" or "Call Dick, he knows more about
3 that kind of issue you have." Which might be possible,
4 you might be talking to a person who doesn't understand
5 that type of issue and public utilities are a highly
6 specialized -- they're the largest block in the market
7 today in revenue bonds, but they're still highly
8 specialized. Some people only understand tax GO's, and
9 they're split up between two or three kinds of tax
10 assessment bonds that are on the market. And people deal
11 in those kinds of bonds and know their buyers.

12 MR. VOGT: That's all. I looked through my
13 notes, I don't think we need to go into anything else.

14 MR. APPEL: That's the movie, folks.

15 SENATOR GOULD: Dr. Strangelove.

16 SENATOR BOTTIGER: What are the solutions?
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1 MR. APPEL: You can also see that people went
2 into this with good faith and good intention. It is an
3 immense transaction, the whole thing, and clearly it's
4 gotten beyond individual capacity in terms of handling a
5 project of this size. And the question is, what people
6 do about it has a lot to do with what their ultimate aims
7 really are and what goods, you know, how many other
8 people are willing to benefit. I'm ready to go off the
9 record.

10 (Discussion off the record.)

11 MR. APPEL: Let's go back on the record and
12 talk about public versus private sale. There are, as I
13 said in the very beginning, there are some drawbacks to a
14 public sale when it comes to bonds. And it really comes
15 out two ways. One is the structuring, and one is the
16 timing. The structuring is what we've been discussing,
17 looking at this graph on the blackboard, what you're
18 looking at is maturity and interest rate and how much you
19 have due in a given year.

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1 And you have to remember that in a publicly
2 sold bond issue, the structuring of a bond issue,
3 determination of what is due when and how and on what
4 terms of prepayment or call or mandatory and optional
5 call, and what the call penalties would be if you prepay
6 any of these is determined by the financial advisor to
7 the issuer.

8 Now, the financial advisor to the issuer may
9 or may not bid on bonds. He may be barred by contract
10 with the issuer that as long as it advised the issuer, it
11 cannot bid. That, incidentally, is what the financial
12 advisor to Seattle King County is subject to. They can
13 advise to structure the bond issue, but cannot bid on
14 bonds. That means, in effect, that one person sets up a
15 bond issue and the rest of the world bids on it.

16 Now, the rest of the world has their own
17 problems, but you have to remember they're all
18 competitors. The financial advisor is usually in contact
19 with other people -- a bidder is also an underwriter.
20 They just change hats.

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1 So what we have is one party who is not going
2 to usually buy the bonds setting up the bond issue, and
3 the timing has to be quite aways down the pike. The
4 bidding may be in 45 or 60 days, and 45 or 60 days in
5 this business is a very long time. A lot of things can
6 happen.

7 So what you do is issue a public prospectus or
8 public bidding and set out what you think you're going to
9 sell with the terms you think you're going to sell on.
10 People attempt to match what they think they can market
11 with what you think you can sell. Which is a mismatch
12 over time, because what they are prepared to market or
13 they can market best is not what you think you can sell
14 best or what you can market best as a seller, and that
15 mismatch results in bad structuring.

16 The second problem is the time you're waiting,
17 45 or 60 days or even longer, because even bond printing
18 takes about three weeks. So a lot of time gets eaten up
19 in a public bond sale while the world simply changes, the
20 investment community changes.

21 If it is a negotiated sale, the underwriter
22 and issuer -- sometimes the underwriter is also
23 recommended by the financial advisor, and I think it
24 would be helpful, because that way you in essence have
25 your own financial advisor negotiating with the

1 underwriter to negotiate the terms of sale.

2 But a negotiated sale doesn't happen that
3 quickly. The underwriter is testing what the market of
4 the issuer is, considering what your real marketing needs
5 are, because the disclosure requirements are the same.
6 You always end up with an official statement of sorts.

7 So the issuer is going through a lot of
8 internal review, the underwriter is putting in overhead
9 which the underwriter expects to recover out of the bond
10 issue and therefore is willing to spend a lot more money
11 on this kind of transaction than if the underwriter is
12 bidding on an and might not get it. Because if they have
13 to spend \$40,000 or \$50,000 getting ready for the bond
14 issue, and they don't get the bids, it's their loss. And
15 all issues have that built in. So you don't gain on that,
16 because it's going to be built into the bond issue, no
17 matter what the bond issuer's underwriter's cost.

18 The other thing that's crucial in timing is
19 that sometimes a market judgment has to be made. 'This
20 isn't a good time, let's wait two weeks. Let's postpone.'
21 And I'm involved in several of those where, for timing
22 reasons, in a negotiated sale everybody gets a better
23 bargain if the timing is very carefully chosen.

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1 A public sale is a blind shot. You've set
2 everything up in advance, and in order for it to be
3 legally secure, you can't make a judgment without looking
4 like you favored one bidder over another.

5 So if it is a difficult issue to sell, it's
6 been my experience that a negotiated sale results I
7 guess -- and of course I never know the alternative,
8 because it's either gone one way or the other, and I've
9 never seen the alternative in any situation -- but what
10 I've observed is there is more satisfaction on both sides,
11 less feelings of frustration, less feelings of regret
12 over, "If we'd only been able to time that. It's too bad,"
13 or "Gosh, we lost all those sales because of this and so."

14 You don't hear that in a negotiated sale
15 because the judgments are very fine-tuned. It's true
16 they wouldn't know what they would have gotten. It's
17 like marriage, you don't know what everybody else would
18 be like as a mate but you've made your choice and
19 optimized as best you could and lived with it. But on a
20 public bond sale, it's really like marriage by auction.
21 You're determined to go through, you set the terms, "Here
22 are my requirements, and I'll marry whoever shows up."
23 And of course, the risk, which is a serious one, is that
24 nobody might show up.

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1 We had an issue like that here in Seattle when
2 we issued about \$4 million worth of local improvement
3 district bonds to consolidate 408 local improvement
4 districts to get Seattle's pension fund out of investment
5 and low interest paper. And there were two consortiums
6 bidding, and then they discovered that they were using
7 the same secondary market. Their salesmen were talking
8 to all the same people. And when the one whose sale
9 people lost, that is, their secondary market was snatched
10 by the other party, they said. 'We're not even going to
11 bid. We're not going to give you a bid.'

12 Then the question came, 'Are we going to get
13 any bidder?' We now know there might be one bidder, but
14 that bidder might not be satisfied. That bidder did come
15 through, and we got a sale, but nobody was really happy
16 with how it came together and what happened.

17 SENATOR BOTTFIGER: What do you do with our
18 problem, as public officials, taking care of our buddy,
19 because he's got our negotiated sale? That's really why
20 public bidding is there, everybody gets a crack at
21 everybody's business.

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1 MR. APPEL: I think in WPPSS there is the
2 least damage of that. I would say of a small issuer
3 there is the most risk. But you have to remember that
4 negotiated sales are actually done more often than any
5 other in this state. All revenue bonds of the smaller
6 municipalities are done by negotiated sales, except in a
7 few instances where a few cities, like Tacoma,
8 deliberately go to a public sale. But they're not
9 required to. All local improvement district sales are
10 negotiated in this state

11 SENATOR GOULD: What is the dividing line
12 between public sales and negotiated sales, then?

13 MR. APPEL: A public sale is a public auction
14 where you say --

15 SENATOR GOULD: I understand.

16 MR. APPEL: The issuer says, "We're going to
17 receive bids."

18 SENATOR BOTTIGER: What makes the difference in
19 a public or a municipality as to whether or not they can
20 go public or have a negotiated sale.

21 MR. APPEL: The statute says.

22 SENATOR GOULD: What's the dividing line in
23 the statute?

24 MR. APPEL: Well, one dividing line is all
25 general obligation bonds, unless they're revenue think

1 bonds, that if they're bonds supported by taxes they must
2 be sold by public sale.

3 SENATOR BOTTIGER: GO bonds?

4 MR. APPEL: Well all of them, whether they're
5 voted or non-voted. But the minute you get into --
6 except in one area, that's fire protection districts,
7 which can issue voted general obligation bonds and
8 negotiate the sale. They don't have to go to public sale.
9 And they're small issues.

10 SENATOR BOTTIGER: Is there a statutory
11 pattern of negotiated sales that exists for reasonably
12 large issues?

13 MR. APPEL: As a matter of fact, except for
14 WPPSS, the largest issues are sold by private sale. You
15 look at the Port of Seattle the port is the largest,
16 they have all gone by negotiated sale.

17 SENATOR GOULD: School districts?

18 MR. APPEL: All public sale. They're all GO
19 bonds. See, school districts cannot issue revenue bonds.

20 SENATOR GOULD: So it's only one, it's only
21 revenue bonds?

22 MR. APPEL: All revenue bonds of
23 municipalities, not WPPSS, but of the municipalities, can
24 be sold by negotiated sale.

25 SENATOR GOULD: Now I see where the lines are.

1 MR. APPEL: Local improvement district bonds
2 can be given to the contractor in payment or sold
3 publicly or privately, and again there are a number of
4 statutes on this issue. I would say there are probably
5 30 statutes, each one setting out a different area. But
6 basically it's one area. 39.44 R.C.W., on the GO sales.

7 SENATOR BOTTIGER: Okay.

8 MR. ZIMMERMAN: Are negotiated bond sales
9 usually a higher interest rate?

10 MR. APPEL: Well, as I say, you never know. I
11 will tell you that in peculiar markets, my guess is that
12 they would be equal or lower. And I'll tell you what my
13 experience is, so that you'll be able to put it into a
14 context.

15 I have watched public sales of local
16 improvement district bonds, public bidder, by some other
17 cities. I have watched the city of Tacoma. Tacoma has
18 sold its bonds to the same underwriter for a contract
19 that's gone for a number of years, and I have seen very
20 few sales come in at interest rates equal to what that
21 year in and year out interest rate has been. for that
22 underwriter, has been for the City of Tacoma.

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1 In other words, Tacoma has profited, I think.
2 extremely well. And the reason is that that underwriter
3 has opened up a secondary market and has a continuing
4 relationship and overhead attributable to that market.

5 Tacoma could say, "If you don't give us a good
6 deal, we'll go somewhere else," and that underwriter now
7 has a portion of his office that relies on that business.
8 So there is some clout there. That's all I can tell you
9 about my experience. That is a peculiar bond.

10 The WPPSS bonds, because of market saturation.
11 are peculiar for another reason. Not because of credit,
12 not because they can't be sold in a short conversation,
13 but because the market is saturated. And then it is a
14 relevant issue to be able to tune the buy and sell to
15 what the market is. So I think a negotiated sale is a
16 relevant consideration

17 MR. ZIMMERMAN: Can you not also get into a
18 saturated market area if you go to negotiated bond sales?

19 MR. APPEL: You can, but you'll notice that
20 what the underwriter can do is set the maturities to
21 where they think they can sell at each time.

22 SENATOR BOETTIGER: You get a prior commitment
23 from a large insurance company that they will take so
24 much of a percentage of a certain class, federally
25 guaranteed bond, and include it in your package.

1 MR. APPEL: That's right.

2 MR. VOGT: Bill, there is no requirements in
3 statute as to the term of bonds between zero and 40 years
4 or whatever.

5 MR. APPEL: No.

6 MR. VOGT: So at the moment, WPPSS won't go
7 into this, other than for the negotiated problem. They
8 could go short term entirely and hope five years from now
9 that the market would be different, and they could return
10 those over then.

11 MR. APPEL: Yes. In fact, that's what they
12 did. Their interest rate went high, they went on
13 short-term paper, hope to turn those over between there
14 and there. (Indicating.)

15 SENATOR GOULD: What are the protections for
16 the public in a negotiated sale, then? I assume the
17 protections for the public in a public sale are the fact
18 it's made public and, therefore, you can protect against
19 pay-offs and that sort of thing, and the only reason for
20 not going to negotiated is there might be some sort of
21 pay-off.

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1 MR. APPEL: Let me put it this way. It really
2 is all public. The only difference between the public
3 and negotiated sale is how many people can bid directly
4 with the issuer. But in terms of pay-offs, it seems to
5 me the possibilities are the same either way.

6 SENATOR GOULD: Then maybe the reason to going
7 public was to give everybody a chance, which is another
8 reason we pass laws which allow bidding.

9 MR. APPEL: That's true. My guess is for bond
10 issues up to about \$20 million dollars, I think everybody
11 would have a chance. But once you get up to \$20 million
12 of issues, no single underwriter is going to sell them
13 anyplace, so your underwriters are going to consolidate.
14 And it doesn't matter who is the successful bidder in a
15 public bidding sale, if you looked carefully, if you knew
16 all the bidders who are consortiums, you would find all
17 the same people involved in all of them, because they
18 can't move that many bonds without talking to the same
19 people.

20 MR. VOGT: As I understand negotiated sales,
21 are you not then limiting somehow in the future the
22 number of folks that would be bidding because of
23 saturation?

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1 MR. APPEL: Well, that has to do with the
2 market, and it has nothing to do with the mode of sale.
3 Yes, in answer to your question, that's what's already
4 happened, and that's why the balance financing there and
5 there is already a limitation of who can come in possibly.
6 And that's already happened, but that's independent of
7 how you sell the bonds.

8 MR. VOGT: Is there a problem with a
9 negotiation of the issuer being taken to the cleaners
10 because they aren't perceptive enough to know what their
11 strength is in terms of what kind of deal they can really
12 cut?

13 MR. APPEL: That's why, usually, on a
14 substantial issue, the issuer may have its own financial
15 advisor. That's exactly what I was saying earlier, is
16 you have your own financial advisor who says, "Wait a
17 minute, if you sign this, this is what's going to happen."

18 MR. VOGT: So you think maybe one possibility
19 is to require, if you were to authorize a negotiated sale,
20 is that the issuer employ a financial advisor to work
21 with them on that? Is that necessary?

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1 MR. APPEL: For instance, that's what the
2 Washington Health Authority would. Washington Health
3 Facilities Authority has done, is they have Frank
4 Grimmelman. I believe, who is a financial expert on
5 hospital issues, and he is on their staff, I suppose on
6 an issue-by-issue basis. All of their bonds are
7 negotiated sales, but he says, "Here's what I'll permit
8 you to have, and here's what I will not permit you to
9 have."

10 MR. VOGT: Are they required by statute?
11 That's what I'm saying.

12 MR. APPEL: I can't answer that. I don't know.

13 SENATOR GOULD: I think they're established by
14 statute. WHI is not a statutory agency.

15 MR. APPEL: I think they are.

16 SENATOR GOULD: Is it?

17 MR. APPEL: Yes. That's what the Supreme
18 Court held earlier.

19 MR. VOGT: My question is, if you went to
20 negotiated sales, would it be desirable to say you can go
21 to negotiated but you must employ a financial advisor to
22 help you, or would they do it anyway?

23 MR. APPEL: You're talking about bond issues of
24 a magnitude that it's hard for me to imagine of that.
25 I think they would do it out of need.

1 SENATOR BOTTIGER: Let me throw a curve at
2 you. I'm thinking purely of political. of what can be
3 sold and what can't be sold. Is it beyond reason that
4 there could be a requirement if there was a negotiated
5 sale and WPPSS had their own financial advisor, that they
6 also confer with the state finance committee on the
7 selection?

8 MR. APPEL: All I can say is it would be legal.
9 All I can say is I'm tying in some elements of negotiated
10 sales. So far as approval, you're asking whether they
11 can require state approval?

12 SENATOR BOTTIGER: I don't want to approve it,
13 I just want to concur in it. I'm looking for the answer
14 to the objection that WPPSS is a little closed shop over
15 there already, and now you're going to let them hire
16 their own bond expert to do their own thing.

17 MR. APPEL: One of the things you suggested is
18 to allow WPPSS to issue bonds that didn't have the word
19 "Washington" in them. It may be a little late, but it
20 seems to me that word Washington is the reason you're
21 reacting the way you're reacting.

22 SENATOR GOULD: Maybe we can get that on the
23 consent calendar.

24 MR. APPEL: And its bonds say it's neither the
25 faith nor the credit, but it rings the bell.

1 MR. ZIMMERMAN: Let me ask you this. I'm at a
2 loss here. If we, the legislature permits the negotiated
3 sale of bonds from WPPSS, does that prevent them from
4 going to public issue?

5 MR. APPEL: No. Usually what the statute says
6 is "to be sold in such manner as commission of the body
7 may determine." That's the way improvement district
8 issues read, that's the way most revenue bond issues read.
9 And the way the statute is now, you can go to public sale,
10 but you don't have to. And some do, some elect to.

11 MR. ZIMMERMAN: So in a word, they're just
12 asking for another avenue.

13 MR. APPEL: Yes, an alternative. And I guess
14 what I'm saying is, considering what I understand to be
15 the circumstances, it is a reasonable request on that
16 issue.

17 MR. VOGT: But if you tag in the finance
18 committee there, which you might want to do to satisfy
19 people, then you get the hand on the tarbaby maybe.
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1 MR. APPEL: Well, the other thing is the
2 finance committee can't do anything. You get the risk of
3 liability without power, and that's the worst possible
4 way to have it. You know, if you're trying to limit what
5 they're doing, you're going to have to build in the
6 limitations in the statute. If you say they go and talk
7 to somebody, usually the finance committee, John Hitchman
8 is going to say, Come talk to me. "There is nothing I
9 can do it about it." Or "I'll just have a WPPSS file now.

10 SENATOR BOTTIGER: Let's proceed on. I don't
11 know about anybody else, but I have to be out of here by
12 four.

13 (Off the record at 3:15 p.m.)
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