

BEFORE THE NORTH CAROLINA UTILITIES COMMISSION

Docket No. E-2, Sub 1262

Docket No. E-7, Sub 1243

In the Matter of	)	
Joint Petition of Duke Energy	)	Direct Testimony of
Carolinas, LLC and Duke Energy	)	PAUL SUTHERLAND, SENIOR
Progress, LLC Issuance of Storm	)	ADVISOR – Saber Partners,
Recovery Financing Orders	)	LLC

**BEFORE THE NORTH CAROLINA UTILITIES COMMISSION**

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**Direct Testimony of**

**Paul Sutherland, Senior Advisor**

**Saber Partners, LLC**

**December 21, 2020**

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**TESTIMONY OF PAUL R. SUTHERLAND**  
**DECEMBER 21, 2020**

**Introduction**

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

2       A.   Paul R. Sutherland, Saber Partners, LLC (Saber or Saber  
3       Partners), 260 Madison Avenue, Suite 8019, New York, New York  
4       10016.

5       **Q.   BY WHOM ARE YOU EMPLOYED AND WHAT IS YOUR**  
6       **POSITION?**

7       A.   I am with Saber Partners, LLC, and serve as a Senior Advisor.

8       **Q.   PLEASE DESCRIBE YOUR DUTIES AND RESPONSIBILITIES**  
9       **IN THAT POSITION.**

10      A.   My responsibilities with Saber include work in data management,  
11      financial modeling, financial analysis, issuance cost auditing, deal  
12      structuring, pricing analysis with respect to relative value and  
13      review of issuance advice letters, mostly on behalf of public utility  
14      commission clients and generally related to utility sponsored  
15      Ratepayer-Backed-Bond (RBB) financing. I have performed these  
16      functions while advising the following regulatory bodies regarding  
17      utility securitizations: Public Utility Commission of Texas, West  
18      Virginia Public Service Commission, New Jersey Board of Public  
19      Utilities, Florida Public Service Commission, and the Wisconsin

1 Public Service Commission. I have also provided testimony on  
2 behalf of the California Community Choice Association.

3 **Q. PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND**  
4 **AND PROFESSIONAL EXPERIENCE.**

5 A. I have a bachelor's degree in electrical engineering from Cornell  
6 University. I also have a master's degree in business  
7 administration from the University of Chicago.

8 I began working with Florida Power & Light Company (FPL) in  
9 1976 doing economic analysis of new energy technologies in the  
10 Research and Development (R&D) Department. After several  
11 years, I moved to the Finance Department as a Financial Analyst.  
12 Over the next 20 years I held various positions, including  
13 Coordinator of Financial Systems, Manager of Corporate Finance,  
14 Manager of Financial Analysis and Forecasting, and Assistant  
15 Treasurer of both the utility and FPL Group Capital. Before leaving  
16 FPL in 1998, I was Director of Finance, Accounting & Systems for  
17 the FPL Energy Marketing and Trading Division. During my time  
18 with FPL, I testified as an expert witness on cost of capital and  
19 financial integrity. I also taught classes on economic decision-  
20 making and on quality improvement. It was during this time (1989)  
21 that FPL became the first non-Japanese company to win the  
22 Deming Prize for Total Quality Management.

1 In 2000, after a year as adjunct professor of mathematics at Palm  
2 Beach Atlantic College, I joined Saber Partners, LLC, as a Senior  
3 Managing Director. I have been associated with Saber Partners  
4 since that time in various roles, including my current position as  
5 Senior Advisor. I have taken part in 13 investor-owned utility  
6 securitization financings that raised over \$9 billion in capital for  
7 eight different utilities.

8 **Q. PLEASE PROVIDE SOME OF YOUR BACKGROUND AND**  
9 **EXPERIENCE WITH UTILITY FINANCINGS WHILE YOU WERE**  
10 **AT FPL.**

11 A. While at FPL, as Manager of Corporate Finance and Assistant  
12 Treasurer, I helped FPL complete over \$2 billion of debt and equity  
13 financings in the public capital markets. FPL executed both  
14 competitive and negotiated securities offering transactions. FPL  
15 was also among the first to issue long-term variable rate tax-  
16 exempt debt that could be (and was) later converted to a fixed  
17 rate. Part of my job, along with the Treasurer and Chief Financial  
18 Officer, was to prepare and deliver rating agency presentations to  
19 support the credit ratings from the three major rating agencies.

20 **List of Exhibits**

21 **Q. ARE YOU SPONSORING ANY EXHIBITS IN THIS CASE?**

22 A. Yes, I am sponsoring:

1

2 Exhibit 1, List of Prior Utility Securitization Transactions with  
3 Tranches and Weighted Average Lives (WALs)

4 Exhibit 2, 2001-2006 Texas vs Non-Texas Deals

5 Exhibit 3, Citigroup Analysis of Texas Interest Savings

6 Exhibit 4, 2001 to 2012 – Spreads to Swaps of 9-10 Year WAL  
7 Tranches

8 Exhibit 5, Methodology for Relative Value Benchmarking

9 Exhibit 6, Standard Deviation of Spreads to Swaps vs. Spreads to  
10 Agencies

11 Exhibit 7, Duke Energy Florida (DEF) Interest Savings

12 Exhibit 8, Atkins' Interest Rate Assumptions

13 Exhibit 9, How Much Does Size Matter?

14 Exhibit 10, AYE (Alleghany Energy Inc.) 2009 Interest Savings

15 Exhibit 11, Glossary

16 **Q. ON WHOSE BEHALF ARE YOU TESTIFYING IN THIS**  
17 **PROCEEDING?**

18 A. I am testifying on behalf of the Public Staff of the North Carolina  
19 Utilities Commission, which represents the interests of the  
20 ratepayers of Duke Energy Carolinas, LLC (DEC), and Duke

1 Energy Progress, LLC (DEP) (together, "the Companies"), relating  
2 to the utilities' proposed use of storm recovery bond (SRB)  
3 financing. The Public Staff hired Saber Partners, LLC, as its  
4 consultant in this proceeding.

5 **Purpose of Testimony**

6 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?**

7 A. The purpose of my testimony is to

- 8 • discuss and demonstrate how ratepayers benefit from RBB  
9 financing, and more specifically, ways in which that benefit can be  
10 measured and maximized through optimal structuring and  
11 application of "best practices" by a Bond Team,
- 12 • explain how negotiated bond pricing can be evaluated under  
13 market conditions leading up to, and at the time of pricing based  
14 upon relative value with respect to comparable benchmark  
15 securities,
- 16 • discuss reasons for and potential benefits of extending final  
17 maturity beyond 15 years,
- 18 • point out several misleading or erroneous statements,  
19 calculations, or assumptions in the testimony of the Companies'  
20 witness Atkins, some of which carry over into the exhibits of the  
21 Companies' witness Abernathy.

1           • suggest certain other changes to the proposed Financing Order.

2           Since some of the terms that I and other witnesses use may be  
3           unfamiliar to those who have not previously been involved in this  
4           type of utility securitization financing, I have included a glossary of  
5           terms as Exhibit 11.

6           **Q. DO YOU KEEP TRACK OF ALL UTILITY SECURITIZATION**  
7           **TRANSACTIONS?**

8           A. I do. Exhibit 1 shows a list of 67 distinct utility securitization  
9           transactions that have occurred since 1997. I maintain this list as  
10          part of Saber's database of documents and statistics from each of  
11          the 67 prior deals. The exhibit includes principal amount by  
12          tranche (sometimes also called "series" in the context of corporate  
13          bonds) and the weighted average life (WAL), in years, for each  
14          tranche.

15          **Q. DOES YOUR LIST AGREE WITH DEF WITNESS ATKINS'**  
16          **EXHIBIT 3?**

17          A. Not exactly. Our list includes the \$482.9 million taxable portion of  
18          the Long Island Power Authority (LIPA) 2013 securitization  
19          transaction. Neither of our lists includes the tax-exempt portion of  
20          the offering, since those bonds were priced and sold in the  
21          municipal market. Because the interest for bonds issued into that  
22          market is exempt from federal income taxes, the market for those

1 LIPA bonds is different from the market for all other investor-  
2 owned utility transactions, as the tax advantage gives those LIPA  
3 bonds an advantage in pricing over bonds without federal tax-  
4 exempt interest. None of the SRB debt in this proceeding will be  
5 tax-exempt municipal securities that have such a different investor  
6 base.

7 Another difference is that the Atkins list misstates the pricing date  
8 of the Hawaiian Electric transaction as 11/13/14 when, in fact it,  
9 was 11/4/2014.

#### 10 **Determinants of Savings and Role of Bond Team**

#### 11 **Q. WHERE DO RATEPAYER SAVINGS COME FROM IN A** 12 **UTILITY SECURITIZATION?**

13 A. The biggest net present value (NPV) savings result from  
14 the fact that rating agencies generally treat utility securitization  
15 debt as off-balance sheet. This means that, unlike conventional  
16 utility debt, securitization debt does not need to be offset with a  
17 similar amount of common equity to maintain an acceptable  
18 capital structure. The avoidance of the high cost of equity, together  
19 with the associated state and federal income taxes, can account  
20 for as much as two thirds of the total savings. Most of the rest of  
21 the NPV savings comes from the fact that securitization payments  
22 are usually levelized, as will be the case with this SRB financing,

1           whereas traditional utility financing has a structure with declining  
2           revenue requirements. A relatively smaller contribution to savings  
3           comes from the interest rate differential between AAA-rated  
4           securitization debt and traditional, lower rated utility debt. To some  
5           degree, these savings are going to be present, regardless of how  
6           well the financing is executed.

7           **Q.    WHAT ARE THE BIGGEST DETERMINANTS OF RATEPAYER**  
8           **SAVINGS OVER WHICH THE BOND ISSUER HAS SOME**  
9           **CONTROL IN AN SRB FINANCING?**

10          A.    There are two major determinants in addition to various smaller  
11          factors that affect ratepayer savings. The first is the interest rate  
12          that the ratepayer has to pay on the bonds. The second is the  
13          structure of the financing, which can include the time period over  
14          which the ratepayer has to repay the principal amount that is being  
15          financed or the size or number of the tranches (or series) that  
16          make up the total financing, or even the legal framework used. In  
17          each case, the final determination of each of the two factors is  
18          limited by constraints that may or may not be beyond the control  
19          of the issuer. In most cases the issuer has some control over both  
20          the interest rate and the structure. Also, when I refer to the issuer  
21          in this context, I am really talking about the entire Bond Team,  
22          defined as a team comprised of the sponsoring utility, the Utilities  
23          Commission, the Public Staff, their financial advisors, and others

1           who are all, presumably, working on behalf of the ratepayers,  
2           since unlike conventional utility debt, with SRBs the ratepayer is  
3           directly responsible for repayment of the bonds. In my opinion, this  
4           is the strongest reason why the Public Staff and its advisors should  
5           have equal say with the utilities in planning and execution of the  
6           financing in question. The admittedly limited control that the issuer  
7           has over interest rates and structure can nonetheless have major  
8           impacts on the NPV savings over the life of the bonds.

9           **Q.    IN YOUR VIEW, SHOULD THE COMMISSION GIVE THE**  
10           **COMPANIES BROAD FLEXIBILITY TO ESTABLISH THE**  
11           **FINAL TERMS AND CONDITIONS OF THE BONDS AS**  
12           **SUGGESTED BY ITS WITNESSES ATKINS AND HEATH?**

13          A.    No. Were these normal utility bonds subject to standard review  
14           and approval by the Commission, the Commission could easily  
15           grant that broad flexibility because it would have the authority for  
16           an unlimited after-the-fact review. In this case, however, the  
17           Commission does not have that opportunity, as described by other  
18           witnesses. As such, the Commission's Order in this proceeding  
19           should require that the final terms and conditions be determined  
20           in a joint, collaborative process with the Commission, the Public  
21           Staff, and/or its independent advisors participating actively, visibly,  
22           and in real-time. The exhibits I am sponsoring, I believe, amply  
23           demonstrate the benefits that accrue to ratepayers from

1           employing best practices, and in particular, from providing the  
2           Public Staff and its advisors equal authority with other members  
3           of a Bond Team to make major decisions involving structuring,  
4           marketing, and pricing of the SRBs.

### **How Interest Rates Are Established**

5           **Q. PLEASE EXPLAIN HOW THE INTEREST RATE ON RBB**  
6           **FINANCING IS DETERMINED UNDER ANY PARTICULAR SET**  
7           **OF MARKET CONDITIONS.**

8           A. RBBs, in this case SRBs, are normally priced by establishing a  
9           spread between the yield or bond interest rate and a particular  
10          benchmark security. Historically, most such bonds have been  
11          priced based on a spread known as an interest rate swap security,  
12          similar to how asset-backed securities customarily are priced.  
13          However, as Public Staff witness Heller explains, securitization  
14          debt is not really an asset-backed security, although it may have  
15          some characteristics in common. Consequently, in the case of the  
16          Duke Energy Florida (DEF) storm recovery financing in 2016, the  
17          bonds were priced relative to U.S. Treasury bonds, which is the  
18          benchmark typically used for corporate debt securities. Either way,  
19          the market determines the yields on the pricing benchmark  
20          securities, either swaps or U.S. Treasury bonds. Then, the issuer  
21          negotiates a spread based on one or the other of the benchmarks  
22          and that determines the actual interest rate on the bonds. As an

1 example, in the case of the DEF nuclear asset recovery bond sale  
2 in 2016, the five-year series, that is to say the series with a WAL  
3 of five years, was priced from the five-year U.S. Treasury bond  
4 with a coupon of 1.375% which was yielding 1.131% at the time.  
5 The Bond Team negotiated a spread of 60 basis points or 0.60%,  
6 so the yield on the nuclear asset recovery bond five-year series  
7 was set at 1.731%. Since market prices and yields change minute  
8 to minute, it is impossible to say exactly what the final yield will be  
9 until the moment of pricing. However, the issuer and investors can  
10 agree on the 60-basis point spread in the minutes or hours  
11 beforehand to avoid worry about last minute movements in the  
12 market.

13 **Q. WHAT HAPPENS IF THERE IS NO PRICING BENCHMARK**  
14 **SECURITY WITH EXACTLY THE SAME MATURITY AS THE**  
15 **WAL OF THE SERIES BEING PRICED?**

16 A. In that case, the issuer and investors will look for pricing  
17 benchmarks with maturities that are near to the WAL of the  
18 securitization series. In such situations, some underwriters like to  
19 negotiate a spread to the pricing benchmark that has the closest  
20 maturity to the RBB WAL. For example, consider the 15.2-year  
21 WAL series in the DEF deal. Underwriters might prefer to price the  
22 series off of the 10-year U.S. Treasury bond. That bond had a  
23 coupon of 1.625%, was due on 5/15/26, and yielded 1.608%. The

1 spread to such a pricing benchmark is known as the T-spread and  
2 was 125 basis points at the time of pricing. However, it is difficult  
3 for the issuer to judge the reasonableness of such pricing due to  
4 the difference between the WALs of the two securities (10 years  
5 versus 15.2 years).

6 **Q. IS THERE A BETTER WAY TO PRICE SUCH BOND SERIES?**

7 A. A better way to price such series is to interpolate between the  
8 closest pricing benchmark securities on either side of the WAL of  
9 the series in question. Thus, in the case of the 15.2-year WAL  
10 series, the issuer can interpolate between the 10-year U.S.  
11 Treasury bond and the 30-year U.S. Treasury bond to get a rate  
12 that corresponds to a theoretical 15.2-year Treasury rate. That  
13 interpolated rate would be approximately 1.826%. The spread  
14 between the interpolated U.S. Treasury bond rate and the rate on  
15 the RBB being priced is known as the g-spread. In this case, the  
16 g-spread was approximately 103 basis points, so the 15.2-year  
17 series was priced a little more than 1.03% above the interpolated  
18 U.S. Treasury bond rate of 1.826% to yield 2.858%. The g-spread,  
19 although not generally favored by underwriters as a pricing  
20 benchmark, is more often used by investors in deciding whether  
21 or not to purchase bonds.

## Power of the Issuer and Measuring Performance

1       **Q.    HOW MUCH ABILITY DOES THE ISSUER HAVE TO**  
2       **NEGOTIATE THE YIELD ON THE BONDS?**

3       A.    While the issuer has no ability to negotiate the underlying pricing  
4       benchmark rate, be it the swap rate or the U.S. Treasury bond  
5       rate, the issuer can certainly negotiate the spread off of those  
6       pricing benchmark rates. The presence or absence of certain best  
7       practices as discussed by Public Staff witnesses Fichera,  
8       Abramson, Maher, and Klein is a major factor in determining the  
9       likely success of such negotiations. For example, the financial  
10      advisor to the Commission or to the Public Staff most directly  
11      represents the ratepayer and therefore has the greatest incentive  
12      to negotiate the lowest interest rate consistent with market  
13      conditions. If the advisor has the authority as a Bond Team  
14      member to fully participate in the structuring, marketing, and  
15      pricing of the bonds, there will be greater ability to negotiate the  
16      tightest possible credit spreads and therefore the lowest possible  
17      yields on the bonds.

18      **Q.    WHAT EVIDENCE IS THERE THAT SUCH BEST PRACTICES**  
19      **HAVE RESULTED IN LOWER INTEREST COSTS COMPARED**  
20      **TO FINANCINGS THAT DID NOT EMPLOY BEST PRACTICES?**

21      A.    One of the first regulatory authorities to employ the best practices  
22      in question was the Public Utilities Commission of Texas (PUCT).

1           During the period from 2001 through 2006, there were six utility  
2           securitizations completed in Texas with a total of 26 individual  
3           tranches with WALs from 1.9 to 13 years. Each of those  
4           transactions followed best practices as required by the PUCT.  
5           During that same period, there were 18 transactions outside of  
6           Texas which generally did not follow some or all of the best  
7           practices required in Texas. Exhibit 2 shows how all of those  
8           tranches were priced. The two regression lines demonstrate that,  
9           on average, the Texas tranches priced significantly better (i.e.,  
10          lower spreads to the swap benchmark and therefore lower interest  
11          rates) compared to the non-Texas tranches.

12          **Q.    IS THERE A WAY OF QUANTIFYING THE SAVINGS SHOWN**  
13          **IN CHARTS SUCH AS EXHIBIT 2?**

14          A.    Yes. Exhibit 3 is an analysis done by Citigroup in 2003 estimating  
15          interest savings from the first three utility securitizations done  
16          using best practices in Texas between 2001 and 2003 and  
17          comparing them to all utility securitizations done between 1997  
18          and 2003, graphically comparing securitization pricing spreads to  
19          swaps, U.S. Treasury bonds, and credit card securitizations. The  
20          study quantifies interest savings based on the swap spread pricing  
21          difference between the Texas deals and all other deals. The study  
22          calculates a total present value interest savings for the three  
23          Texas deals of \$7,533,476. Subsequently, Citigroup reran its

1 analysis using a shorter time span, I believe it was 2001 to 2003,  
2 and calculated NPV savings of about \$17 million (nominally \$23  
3 million) for the same three Texas deals. These were the three  
4 transactions which witness Rebecca Klein oversaw as Chair of the  
5 PUCT, and Saber Partners served as financial advisor to the  
6 PUCT for each of these three transactions.

7 **Q. HOW CAN THE SAVINGS CALCULATION BE SO DIFFERENT**  
8 **FOR THE SAME THREE TRANSACTIONS?**

9 A. The differences in the savings calculation result from the fact that  
10 savings estimates are sensitive to the time period over which the  
11 comparisons are made. Generally, the more stable interest rates  
12 are over the comparison period, the more valid the comparisons  
13 are, since spread relationships change over time, independent of  
14 how well any particular pricing is executed. Exhibit 4 shows how  
15 swap spreads changed dramatically during the financial crisis of  
16 2008 and 2009.

17 **Q. IS THERE ANY OTHER WAY OF MEASURING PRICING**  
18 **PERFORMANCE BESIDES COMPARING PRICING WITH**  
19 **BENCHMARK SWAP SPREADS?**

20 A. Yes, there is, especially after the financial crisis of 2008 and 2009.  
21 Exhibit 4 shows pricing spreads to swaps for tranches in the range  
22 of nine- to 10-year WAL from 2001 to 2012. There are two  
23 important points to note from this chart. First, from 2001 through

1           2007, transactions in which Saber Partners acted as financial  
2           advisor following best practices led the march toward tightening  
3           spreads, as every deal had tighter spreads than the preceding  
4           deal. The second point is that with the financial crisis of 2008-2009  
5           and its aftermath, pricing spreads to swaps widened dramatically,  
6           and only partially recovered in the years after. It seems apparent  
7           that, with spreads changing so substantially over short periods of  
8           time, it would be misleading to try to compare performance of one  
9           deal to others if the deals were more than a year or two apart. We  
10          believe the solution is to do what is called relative value  
11          benchmarking with types of securities that price closer to utility  
12          RBBs than either U.S. Treasury bonds or swaps.

13          **Q.    PLEASE EXPLAIN WHAT YOU MEAN BY “RELATIVE VALUE**  
14          **BENCHMARKING.”**

15          A.    Exhibit 5 is a paper that I authored explaining in detail what we  
16          mean by relative value benchmarking and how it works. Basically,  
17          it involves looking at a range of types of securities that are, at least  
18          in some way, comparable to utility RBBs. These might include  
19          AAA-rated corporate bonds such as Johnson & Johnson (JNJ)  
20          and Microsoft (MSFT). It could include AAA-rated credit card  
21          securitizations, which are in fact asset-backed securities. It could,  
22          and in fact should, include AAA-rated U.S. agency debt by such  
23          issuers as Fannie Mae (FNMA), Federal Home Loan Bank

1 (FHLB), or the Tennessee Valley Authority (TVA). The basket of  
2 comparables could even include some electric utility debt, even  
3 though there are no AAA-rated utilities. By comparing yields on  
4 these types of securities to the indicative rates provided by the  
5 underwriters in the weeks and days leading up to pricing, the  
6 issuer can get a good sense of the reasonableness of those  
7 indicative rates. For example, if the indicative spreads on the  
8 RBBs would result in a higher yield than on electric utility corporate  
9 debt, then there is definitely something wrong with the price  
10 indications given by the underwriters.

11 **Q. YOU HAVE EXPLAINED HOW RELATIVE VALUE**  
12 **BENCHMARKING IS USED LEADING UP TO PRICING. HOW**  
13 **CAN IT BE USED AFTER PRICING TO MEASURE THE**  
14 **SUCCESS OR FAILURE OF PRICING RELATIVE TO OTHER**  
15 **SECURITIZATION TRANSACTIONS?**

16 A. Each of the types of comparable securities listed in my previous  
17 answer is imperfect in some way as a measure of pricing  
18 performance; JNJ and MSFT because they are the only two  
19 corporate AAAs; credit card securitizations because they do not  
20 exist for longer maturities and because they carry prepayment risk  
21 that utility securitization debt does not; U.S. agency securities  
22 because it would be easy to cherry-pick the best debt issues

1 among them so as to make a particular utility securitization pricing  
2 look good in retrospect.

3 **Q. WHAT IS THE SOLUTION TO THESE PROBLEMS?**

4 A. The solution is to use U.S. agency debt, but to let an unbiased  
5 third party pick the particular debt issues among all the U.S.  
6 agency debt securities outstanding. This avoids the possibility of  
7 so-called cherry picking to make a particular pricing look good or  
8 bad according to one's bias. In this case, the unbiased third party  
9 is the Bloomberg Terminal, a computer software system that  
10 provides financial information and data to financial professionals  
11 in all major corporations. The data include both current and  
12 historical prices and yields for a seemingly infinite variety of debt  
13 and equity securities. In addition to publishing prices and yields on  
14 individual debt issues, Bloomberg publishes a yield curve for U.S.  
15 agency debt, for which it picks specific agency issues for various  
16 maturities along the curve. These data can then be used to  
17 calculate spreads at the time of pricing any particular utility  
18 securitization. This yield curve is called the I-26 Agency Curve.  
19 Securitization spreads can be calculated to interpolated agency  
20 yields in the same way that they are calculated to interpolated U.S.  
21 Treasury bond yields.

22 **Q. WHY IS IT BETTER TO USE SPREADS TO U.S. AGENCY DEBT**  
23 **AS A MEASURE OF PERFORMANCE RATHER THAN**

1                   **SPREADS TO SWAPS AS WAS DONE IN EXHIBITS 2, 3, AND**  
2                   **4?**

3           A.     Before the financial crisis of 2008-2009, it would not have made  
4                   much difference which benchmark was used. However, as Exhibit  
5                   4 shows, the crisis caused the relationship between swaps and  
6                   utility securitization debt to change significantly. While the  
7                   relationship between U.S. agency debt and securitization debt  
8                   also changed, the effect was much smaller. The relative changes  
9                   can be seen in Exhibit 6, which shows the securitization spreads  
10                  to swaps and spreads to U.S. agency debt for all utility  
11                  securitizations in the years before and after the financial crisis.  
12                  The charts show the relative stability of the two relationships by  
13                  comparing the standard deviations in each case. In the period  
14                  before the financial crisis, the standard deviation for spreads to  
15                  swaps (15.8 basis points (bps)) was almost the same as for  
16                  spreads to U.S. agency debt (14.8 bps). However, after the crisis,  
17                  the standard deviation for swaps increased dramatically to 25.6  
18                  bps, while for U.S. agency debt, it decreased slightly to 13.7 bps.  
19                  When attempting to measure relative success of one utility  
20                  securitization against others, it is necessary to compare  
21                  transactions that occurred in particular time periods. Therefore, a  
22                  good benchmark for this purpose is one that is more stable over  
23                  time. Exhibit 6 supports the conclusion that the spreads to U.S.

1 agency debt as measured by interpolated yields from the  
2 Bloomberg I-26 curve are more stable with less variability and  
3 therefore a better measure than swap spreads.

4 **Q. BESIDES USING A DIFFERENT BENCHMARK SECURITY, DO**  
5 **YOU GENERALLY FOLLOW THE METHODOLOGY USED IN**  
6 **THE CITIGROUP ANALYSIS TO CALCULATE INTEREST**  
7 **SAVINGS FROM FOLLOWING BEST PRACTICES?**

8 A. Generally, yes. We calculate both nominal and NPV savings after  
9 each financing for which we act as advisor, comparing that pricing  
10 of that transaction to securitizations that have priced in the  
11 recently preceding years for which we did not act as advisors. We  
12 focus on NPV savings since they are more relevant to the financial  
13 interests of the ratepayer than nominal savings, taking into  
14 account the time value of money. Unlike the Citigroup analysis, we  
15 do the analysis for each transaction we complete individually so  
16 that each deal has its own set of comparable deals. Citigroup, on  
17 the other hand, used a single group of comparable deals to  
18 evaluate all three Texas deals.

19 **Q. WHAT INTEREST RATE DO YOU USE TO DISCOUNT**  
20 **INTEREST SAVINGS?**

21 A. We have come to the conclusion that the petitioning utility's overall  
22 weighted average cost of capital (WACC) is the best proxy for the  
23 ratepayers' cost of capital. That is, in my opinion, the theoretically

1 correct rate to use, since securitization debt is a direct obligation  
2 of the ratepayers and not the utility. In the present case, DEC and  
3 DEP are discounting at the after-tax WACC, which is below both  
4 the pre-tax and the overall WACC. I don't believe it makes a  
5 material difference in this proceeding which WACC is used. Many  
6 utility commissions choose to use the RBB rate to discount interest  
7 savings, which is much lower and which I believe likely overstates  
8 interest savings from the ratepayers' perspective.

9 **Q. CAN YOU SHOW AN EXAMPLE OF THE APPLICATION OF**  
10 **YOUR APPROACH TO CALCULATING INTEREST SAVINGS**  
11 **IN A UTILITY SECURITIZATION POST FINANCIAL CRISIS?**

12 A. Yes. The DEF nuclear asset recovery issue priced on 6/15/2016.  
13 Exhibit 7 shows how the five series priced relative to all other utility  
14 securitizations from 2010 to 2016 in terms of spreads to the  
15 Bloomberg I-26 U.S. agency bond yield curve. The chart shows  
16 that the first three series, with WALs of two, five, and ten years,  
17 respectively, priced almost exactly on the regression line for all  
18 other transactions in that timeframe. However, the two longer  
19 series, with WALs of 15.2 and 18.7 years, respectively, priced well  
20 below the regression line. The difference between the regression  
21 line, which you could consider as average pricing performance,  
22 and the actual spread to U.S. agency bonds represents interest  
23 savings to the ratepayers. Discounted at DEF's WACC at that time

1 of 8.12%, the NPV savings for ratepayers amounts to over \$6.8  
2 million.

3 **Q. DOES THIS MEAN THAT IN THE FUTURE, WHEN YOU PRICE**  
4 **THIS TYPE OF SECURITY, THE AGREED-UPON PRICE WITH**  
5 **THE UNDERWRITERS WILL BE BASED ON A SPREAD TO**  
6 **U.S. AGENCY BONDS RATHER THAN A SPREAD TO SWAPS**  
7 **OR SPREAD TO U.S. TREASURY BONDS?**

8 A. No, it does not. When setting the final pricing of such securities,  
9 we must follow the market convention, which dictates that the  
10 pricing be stated either as a spread to swaps or a spread to  
11 interpolated U.S. Treasury bonds. However, for negotiating prior  
12 to that point as well as for evaluating performance after the deal is  
13 done, in my judgment U.S. agency securities represent the best  
14 relative value benchmark among all the comparable debt types.

### **Savings Through Structural Changes**

15 **Q. YOU STATED PREVIOUSLY THAT THERE IS A SECOND**  
16 **DETERMINANT THAT CAN HAVE A LARGE IMPACT ON**  
17 **RATEPAYER SAVINGS, NAMELY THE STRUCTURE OF THE**  
18 **SRB. PLEASE GIVE AN EXAMPLE OF HOW A STRUCTURAL**  
19 **CHANGE MIGHT INCREASE SAVINGS.**

20 A. In the 2016 DEF securitization, as witness Heller relates in his  
21 testimony, at the suggestion of the Florida Public Utilities

1 Commission's financial advisor, the planned four-tranche structure  
2 was changed to a five-tranche structure about a week before final  
3 pricing. The original 16.9-year 4<sup>th</sup> tranche of about \$525 million  
4 was split into two smaller tranches. The A-4 tranche became a  
5 15.2-year WAL, \$250 million tranche and the A-5 tranche was  
6 created as an 18.7-year WAL, \$275 million tranche. The original  
7 A-4 tranche was quoted by the bankers with a g-spread (spread  
8 to US Treasuries) of 117 basis points (1.17%). The final pricing of  
9 the two new tranches was a 103 basis point spread on the new A-  
10 4 tranche and a 116 basis point spread on the new A-5 tranche.  
11 This resulted in 14 basis point savings on \$250 million and one  
12 basis point savings on \$275 million. This created an additional  
13 NPV savings of over \$3 million by just one small structural change  
14 that affected neither the total principal amount, nor the overall  
15 WAL life of the transaction.

16 **Q. ARE THERE OTHER TYPES OF STRUCTURAL CHANGES**  
17 **THAT MIGHT PRODUCE SIGNIFICANT INCREMENTAL NPV**  
18 **SAVINGS FOR RATEPAYERS?**

19 A. Yes. In witness Heath's testimony, he suggests that the  
20 Companies prefer a 15-year amortization period for the bonds  
21 because it "strikes the right balance between the length of the  
22 recovery period and the length and level of the recovery charge."  
23 Witness Heath also states that this is consistent with the longest

1 recovery period proposed by Public Staff in the DEP storm deferral  
2 docket (Docket No. E-2, Sub 1193). He says that DEC and DEP  
3 also considered a 20-year final payment date, but presents no  
4 data in his direct testimony to show the effect of extending the  
5 scheduled final maturity from 15 to 20 years. In response to DR 5-  
6 1, spreadsheets provided by witness Abernathy show that such an  
7 extension would increase NPV savings to ratepayers by over \$63  
8 million total between DEC and DEP.

### **Problems with Testimony of Abernathy and Atkins**

9 **Q. WHAT DID YOUR REVIEW OF THE INTEREST RATE**  
10 **ASSUMPTIONS USED IN WITNESS ABERNATHY'S**  
11 **CALCULATION OF SAVINGS FOR THE 20-YEAR STRUCTURE**  
12 **REVEAL?**

13 A. I found two significant but more or less off-setting errors in the  
14 interest rates used in the calculation.

15 **Q. WHAT WAS THE FIRST ERROR?**

16 A. First, as with the savings calculation for the 15-year scheduled  
17 final structure, Ms. Abernathy relied on an overall interest rate that  
18 was weighting coupons of five tranches by principal amount but  
19 ignoring the WAL of each tranche, thus significantly understating  
20 the true overall rate. It is incorrect to weight the individual coupon  
21 rates just by the principal amounts of the respective tranches.

1           They must also be weighted by their respective weighted average  
2           lives, since obviously an interest rate on Atkins' 18.1-year tranche  
3           has more impact overall than the same interest rate on a 1.7-year  
4           tranche. It appears that she got her overall rate of 1.51% from a  
5           spreadsheet, also attached to response to DR 5-1 but provided by  
6           witness Atkins, which contains rates for the individual 5 tranches.  
7           The correct weighted average interest rate using Atkins' individual  
8           rates for the 5 tranches on the 20-year scheduled final structure  
9           would be 1.83%.

10       **Q.    WHAT IS THE SECOND ERROR?**

11       A.    Witness Atkins obtained his rates for the individual tranches from  
12           Guggenheim. I have taken the rates he used in his direct testimony  
13           and in his responses to two data requests, PS DR 5-1 and PS DR  
14           9-2, for both the 15-year and the 20-year final scheduled maturity  
15           structure and plotted them in Exhibit 8. The graph shows that the  
16           rates for all the tranches fall, more or less, along a trendline above  
17           the yield curve for US Treasury bonds yields, with two obvious  
18           exceptions. The biggest outlier from the PS DR 5-1 response is  
19           the A-5 tranche in the 20-year scheduled final maturity structure  
20           with a WAL of 18.1 years, to which he assigns a rate of 2.54%,  
21           which is 101 basis points above the interest rate of the next closest  
22           tranche at 14 year-WAL with a rate of just 1.53%. The A-5 tranche  
23           appears to be overstated by at 50 to 75 basis points (0.50% to

1 .75%) when compared to the trendline of all other interest rates  
2 provided by witness Atkins for the various tranches in his direct  
3 testimony and in response to PS DR 5-1.

4 **Q. SUBSEQUENT TO RESPONDING TO PS DR 5-1, DID**  
5 **GUGGENHEIM OR WITNESS ATKINS CHANGE THEIR**  
6 **ESTIMATE OF THE A-5 TRANCHE INTEREST RATE?**

7 A. No. In PS DR 9-2.m, the following question was asked in hopes  
8 that the error would be corrected: “In response to PS DR 5-1, there  
9 is an attached excel spreadsheets showing witness Atkins’  
10 assumed interest rates for a 20-year SRB structure in which the  
11 A-4 14-year tranche has an interest rate of 1.53%, equating to a  
12 g-spread of about 50 basis points, whereas the A-5 18.1-year  
13 tranche has an interest rate of 2.54%, equating to a g-spread of  
14 about 130 basis points. Please explain why the DEC/DEP believes  
15 that the 4 additional years of weighted average life for that tranche  
16 should cause such a large increase in credit spread given the  
17 slope of the US Treasury benchmarks?” However, rather than  
18 reduce the rate for the A-5 tranche, the answer given by Witness  
19 Atkins was to raise the rate for the A-4 tranche, in the following  
20 response: “The exhibit to the response to PS DR 5-1 contained a  
21 clerical error in the estimated spreads as of October 9, 2020 that  
22 affected the spread and the yield of the A-4 tranche. The corrected  
23 estimated spreads that were intended to be provided are in the

1 attachment provided with this response.” The rate for A-4 shown  
2 in the excel attachment was 1.88%, up from 1.53%. As shown in  
3 my Exhibit 8, now both the A-4 and the A-5 rates in Atkins’ 20-yr.  
4 scheduled final maturity structure are significantly above the  
5 trendline established by his rates for the 15-year scheduled final  
6 maturity structure as well as the first three tranches of his 20-year  
7 scheduled final maturity structure.

8 **Q. TO WHAT WOULD YOU ATTRIBUTE THE CAUSE FOR SUCH**  
9 **OUTLIER RATES?**

10 A. I believe they are either a result of a carelessness or possibly an  
11 indication of underwriters’ natural inclination to favor shorter  
12 maturities because they are easier to sell. In either case, it would  
13 appear that witness Atkins did not seriously consider the 20-year  
14 scheduled final maturity structure as an alternative to the  
15 Companies’ preferred 15-year scheduled final maturity structure.

16 **Q. ARE THERE, IN YOUR OPINION, ANY FINANCIAL OR NON-**  
17 **FINANCIAL REASONS FOR OR AGAINST EXTENDING THE**  
18 **SCHEDULED FINAL MATURITY BEYOND 15 YEARS?**

19 A. Yes, for both. The argument against extending could be based on  
20 a belief that major storms were going to begin to occur much more  
21 frequently and a desire to avoid “pancaking” capitalized O&M, one  
22 storm after another, i.e., accumulating charges from multiple new  
23 storms before the charges for old storms are completely paid.

1           However, there are several arguments for extending the maturity.  
2           First, in the traditional case presented by witness Abernathy, she  
3           assumes that capitalized O&M is financed over 15 years but the  
4           storm-related capital piece is depreciated over 40 years. If we  
5           were to take the weighted average of those two maturities based  
6           on the principal amounts financed with SRBs, the maturity would  
7           be slightly less than 18 years. Increasing the securitization final  
8           scheduled maturity by just three years increases NPV savings by  
9           about \$40 million for DEC and DEP combined, assuming the  
10          principal amount financed in Atkins Exhibit 4.

11          The second argument supporting a longer maturity with SRBs is  
12          simply that interest rates are within half a percent of the lowest  
13          they have been in the last century or more. Consequently, it is in  
14          both the ratepayers' and the utilities' interest to take full advantage  
15          of such low rates for as long as reasonably possible. After all, there  
16          are very few ratepayers who could borrow funds for less than 2%,  
17          as they would effectively be doing with SRBs.

18          **Q.    WHAT OTHER KINDS OF STRUCTURAL CHANGES MIGHT**  
19          **HAVE SIGNIFICANT FINANCIAL IMPACTS?**

20          A.    Witness Atkins suggests that employing a grantor trust structure  
21          to combine the DEC and DEP bonds into a single bond offering  
22          would avoid what, in his opinion, might be a financial penalty for  
23          the smaller deal size of the DEC bond offering.

1       **Q.     DID WITNESS ATKINS OFFER ANY EVIDENCE THAT SUCH A**  
2       **PENALTY ACTUALLY EXISTS FOR SMALLER OFFERINGS?**

3       A.     In his response to a data request, PS DR 2-8, he pointed to two  
4       paired securitization offerings, one in 2010 and the other in 2014,  
5       in which in each case a smaller offering was sold at the same time  
6       as a larger offering by different but related sponsoring utilities. He  
7       stated that in both cases, the smaller offering was priced with a  
8       higher interest rate than the larger. However, my review of his  
9       quantitative analysis indicates that it was not done correctly, and  
10      thus does not support his contention.

11      **Q.     PLEASE EXPLAIN THE NATURE AND CONSEQUENCES OF**  
12      **THIS ERROR.**

13      A.     In his PS DR 2-8 Supplemental attachment, Witness Atkins  
14      compares a \$468.9 million Louisiana ELL (Entergy Louisiana,  
15      LLC) deal with a \$244.1 million Louisiana EGSL (Entergy Gulf  
16      States Louisiana, LLC) deal, both priced on 7/15/2010 with the  
17      same WAL of 6.6 years. He calculates overall interest rates of  
18      2.795% for the larger ELL deal and 2.819% for the smaller EGSL  
19      deal for a difference of 2.4 basis points per annum or .024%  
20      penalty per annum for the smaller deal. However, it is incorrect to  
21      weight the individual coupon rates only by the principal amounts  
22      of the respective tranches. They must also be weighted by their  
23      respective WALs, since obviously an interest rate on a 10-year

1           WAL tranche has greater impact overall than the same interest  
2           rate on a two-year WAL tranche. When the interest rates are  
3           weighted correctly by principal and WAL, the “penalty” for the  
4           smaller deal is just 1.57 basis points or .0157%, as shown in  
5           Exhibit 9. That difference costs the smaller \$244 million deal just  
6           \$253,000 in additional interest.

7           The consequence of witness Atkins’ error is greater in the 2014  
8           deals. There, he compares a \$243.85 million Louisiana ELL deal  
9           to a \$73 million Louisiana EGSL deal, both priced on 7/29/2014  
10          with a WAL of 6.7 years. His attachment shows an overall rate of  
11          2.646% for the larger deal compared to 2.860% for the smaller  
12          deal for an apparent size penalty of 21.4 basis points or .214%.  
13          However, in this case, when the correct rates weighted by both  
14          principal and WAL are used, the larger deal has an overall interest  
15          rate of 2.9732%, also shown in Exhibit 9, which is 11 basis points  
16          or .11% more expensive than the smaller deal, contradicting  
17          Atkins’ hypotheses that smaller transactions tend to suffer pricing  
18          penalties. That means that the smaller \$71 million deal saved over  
19          half a million dollars in interest by pricing lower than the larger  
20          deal.

21          This result seems to impeach Witness Atkins’ rationale for using  
22          the more complex and more expensive grantor trust structure to  
23          sell the DEC and DEP bonds under a single structure.

1       **Q.    WAS THERE A DATA REQUEST TO WITNESS ATKINS**  
2           **QUESTIONING THE WAY HE CALCULATED WEIGHTED**  
3           **AVERAGE INTEREST RATES?**

4       A.    Yes. PS DR 8-3 asked, “Please provide the weighted average  
5           interest rate for each of the four (4) transactions, weighted by  
6           principal amount and weighted average life of the tranches in the  
7           respective 4 transactions. If witness Atkins did not base his  
8           conclusion that ‘the smaller transaction priced wider’ upon such  
9           weighted average rates, then please explain what it was based on  
10          and provide supporting data”. The response stated “Please see  
11          the Companies' original and supplemental responses to PS DR 2-  
12          8”. The original response to PS DR 2-8.a stated “Please see the  
13          attached spread and coupon information for those transactions  
14          included as an attachment to PS Data Request 2-8”, again  
15          referring to the four Louisiana transactions. However, there was  
16          no such attachment. Subsequently, witness Atkins submitted PS  
17          DR 2-8 Supplemental, which had an attachment containing the  
18          weighted average interest rates, weighted by principal but not by  
19          WAL. He did not explain why he thought that was appropriate to  
20          not consider WAL.

21       **Q.    ARE THERE OTHER UTILITY SECURITIZATIONS THAT**  
22           **MIGHT TEND TO DISPROVE ATKINS' CONTENTION?**

1 A. Yes. In 2007 and again in 2009, Allegheny Power priced a pair of  
2 securitizations for each of two subsidiaries, Monongahela Power  
3 (MP Environmental Funding) and Potomac Edison (PE  
4 Environmental Funding). In each case, the two issuers priced with  
5 the same spreads even though the PE deal was about 1/3 the size  
6 of the MP deal. Exhibit 10 shows the 2009 deals priced better than  
7 expected when compared to two other utility securitizations in the  
8 same time frame.

9 **Q. ARE THERE ANY OTHER INSTANCES WHERE WITNESS**  
10 **ATKINS' MISCALCULATION OF THE WEIGHTED AVERAGE**  
11 **INTEREST RATE MAY BE CAUSING ERRONEOUS OR**  
12 **MISLEADING RESULTS?**

13 A. Yes. In Exhibit 4 to Witness Atkins' direct testimony, he presents  
14 preliminary structures for the DEC and DEP transactions showing  
15 five tranches with five interest rates with a resulting overall interest  
16 rate of 1.15%. If he were to calculate the weighted average rate  
17 correctly, it would be about 1.38% or 23 basis points higher. Since  
18 Witness Abernathy is using Mr. Atkins' overall rate in her savings  
19 calculation, she consequently overstates the savings.

20 **Other Changes to the Proposed Financing Order**

21 **Q. ARE THERE ANY OTHER CHANGES TO THE COMPANIES'**  
22 **PROPOSED FINANCING ORDER THAT YOU WOULD**

1                   **SUGGEST THAT WOULD RESULT IN MATERIAL**  
2                   **RATEPAYER SAVINGS?**

3           A.     There are several, which involve charges during the life of the  
4                   bonds and also collections after the bonds mature. At least four  
5                   utility commissions in eight RBB transactions between 2005 and  
6                   2014 have limited earnings of the sponsoring utility on the capital  
7                   subaccount to actual investment returns on the account, rather  
8                   than requiring ratepayers to provide a return equal to the rate on  
9                   the longest tranche, as stated in the Companies' proposed  
10                  Financing Order. This change from the proposed Financing Order  
11                  would save the Companies' ratepayers, taken together, nominally  
12                  about \$1.2 million over 15 years and on an NPV basis, about  
13                  \$500,000. The funds are in a AAA subsidiary primarily for tax  
14                  purposes and if used at any point, it is trued up immediately thru  
15                  the storm recovery charge on ratepayers on a constant basis. It  
16                  also is returned to the Companies upon the final maturity of the  
17                  bonds. The Companies' capital is not at risk, and thus there is no  
18                  justification in this instance for a higher return to the Company,  
19                  charged to the ratepayers, than actually earned on the account  
20                  itself. The Companies should be allowed to collect no more than  
21                  the actual investment return on the capital subaccount, which is in  
22                  addition to the other considerable benefits that they will receive  
23                  from doing this securitization.

1       **Q.    WHAT BENEFITS, SPECIFICALLY, ARE YOU REFERRING**  
2       **TO?**

3       A.    Under traditional ratemaking as practiced by this Commission,  
4       there is usually a gap between the date of the storms and the next  
5       general rate case. In those instances, the amortization and the  
6       carrying costs are typically presumed to be recovered in existing  
7       rates during the interim period of time. Under the securitization  
8       statute, that is not the case; amortization does not begin until the  
9       bonds are issued, and the Company gets to accrue carrying costs  
10      up to that date. So, use of securitization under these  
11      circumstances ultimately increases the revenue collected by the  
12      Company from the ratepayers by deferring for future collection  
13      many millions of dollars from at least a year's worth of "gap period"  
14      amortization and carrying costs.

15      **Q.    Will the Companies and their SPEs continue to collect storm**  
16      **recovery charge revenues after all the storm recovery bonds**  
17      **have been repaid?**

18      A.    Yes. Customers will no longer be obligated to pay the storm  
19      recovery charge in respect of electricity consumed after all the  
20      storm recovery bonds have been repaid. But customers still will be  
21      obligated to pay storm recovery charges in respect of electricity  
22      consumed through the date on which all storm recovery bonds

1 have been repaid. We sometimes refer to these amounts as “tail-  
2 end collections.”

3 **Q. Can you estimate the amount of tail-end collections in**  
4 **connection with the proposed storm recovery bonds?**

5 A. Yes. Based on assumptions used in the model embedded in the  
6 testimony of witness Byrd’s Exhibit 1 and the Companies’  
7 collection curves provided in response to PS DR 3-2.b, the  
8 Companies and their SPEs would receive approximately \$20  
9 million of tail-end collections. In one way or another, these excess  
10 collections should be credited back to ratepayers.

11 **Q. The proposed form of Financing Order attached as Appendix**  
12 **C to the Joint Petition calls for (i) servicing fees and**  
13 **administration fees collected by the Companies to be**  
14 **included in the Companies’ cost of service, (ii) the**  
15 **Companies to credit back all periodic servicing fees in excess**  
16 **of the Companies’ incremental costs of performing servicing**  
17 **and administrative functions, and the expenses incurred by**  
18 **the Companies to perform obligations under the Servicing**  
19 **Agreement or Administration Agreement not otherwise**  
20 **recovered through the storm recovery charge to be included**  
21 **in the Companies’ cost of service “in the next rate case.” Why**  
22 **is this crediting necessary?**

1 A. In the absence of crediting future rates or some other use of these  
2 fees received by the Companies in excess of their costs incurred  
3 in providing these services, the Companies would recover the  
4 same costs twice from customers. Using witness Heath's  
5 estimated cost of serving fees of .05 percent of the original  
6 principal amount per year, that amounts to \$489,400 per year or  
7 in excess of \$7 million over 15 years for the Companies combined.

8 **Q. Does the proposed form of Financing Order also call for "tail-**  
9 **end collections" of storm recovery charges to be credited**  
10 **back to customers in the Companies "next rate case"?**

11 A. Yes. Page 41 states: "Upon the maturity of the Storm Recovery  
12 Bonds and upon the discharge of all obligations with respect to  
13 such bonds, amounts remaining in each Collection Account will be  
14 released to the appropriate SPE and will be available for  
15 distribution by the SPE to DEP. As noted in this Financing Order,  
16 equivalent amounts, less the amount of any Capital Subaccount,  
17 will be booked to a regulatory liability and credited back to  
18 customers in the Company's next rate case following the maturity  
19 of the Storm Recovery Bonds."

20 **Q. Have commissions in other states devised other mechanisms**  
21 **to provide greater protection for customers against such**  
22 **overcollections of securitization charges?**

1       A.     Yes. In 2006, FPL applied to the FPSC for a Financing Order  
2             authorizing securitized storm recovery bonds to be issued for FPL.  
3             Much of the proceeds of those storm recovery bonds were to be  
4             used to fund additions to an existing Storm and Property  
5             Insurance Reserve Fund (Reserve) which had been established  
6             in 1993 to implement a self-insurance approach to storm costs  
7             through annual contributions from base rate revenues. In the  
8             Financing Order authorizing the issuance of storm recovery bonds  
9             for FPL, the FPSC found that:

- 10            • FPL had not justified that the annual fees for servicing and  
11             administration services was necessary to cover any incremental  
12             costs to be incurred by FPL in performing those services.  
13             Consequently, the FPSC “ORDERED that FPL shall apply to the  
14             Reserve all amounts it will receive under the Servicing Agreement  
15             for ongoing services and that FPL shall apply to the Reserve all  
16             amounts it will receive under the Administration Agreement for its  
17             services.” and
- 18            • “Upon the maturity of the storm-recovery bonds and upon  
19             discharge of all obligations in respect thereof, remaining amounts  
20             in the Collection Account will be released to the SPE and will be  
21             available for distribution by the SPE to FPL. Equivalent amounts,  
22             less the amount of the Capital Subaccount and earnings thereon,  
23             will be credited by FPL to current customers’ bills in the same

1 manner that the charges were collected, or through a credit to the  
2 Reserve or the capacity cost recovery clause if the Commission  
3 determines at the time of retirement that a direct credit to  
4 customers' bills is not cost-effective. FPL shall similarly credit  
5 customers an aggregate amount equal to any Storm Bond  
6 Repayment Charges subsequently received by the SPE or its  
7 successor in interest to the Bondable Storm Recovery Property."

8 **Q. Does providing these rate credits to customers "in the next**  
9 **rate case" provide adequate and appropriate protection for**  
10 **customers against overcollections by the Companies?**

11 A. As Public Staff witnesses Maness and Boswell state in their  
12 testimony in this proceeding, the Companies historically have not  
13 filed rate cases every year, and many years might pass before the  
14 next rate case. For this reason, witnesses Maness and Boswell  
15 recommend that the Commission's Financing Order (i) direct each  
16 Company to establish two deferred accounts with respect to the  
17 proposed storm recovery bonds: a "storm recovery bond excess  
18 fees account" and a "storm recovery bond excess collections  
19 account," (ii) provide that the positive or negative balance in each  
20 of these deferred accounts, adjusted if appropriate for income  
21 taxes and accrued carrying costs at the Companies' respective  
22 net-of-tax weighted average cost of capital, and (iii) direct that the  
23 balances in these deferred accounts be credited to customers in

1 an appropriate fashion in the next general rate case, without  
2 regard to the historical base year used for that next rate case. The  
3 recovery of the deferred credit may or may not be accompanied  
4 by an ongoing credit to reflect continuing expected excess fees  
5 and collections, subject to further true-up. I believe the approach  
6 recommended by witnesses Maness and Boswell would provide  
7 adequate and appropriate protection for customers against  
8 overcollections by the Companies.

### **Summary and Recommendations**

9 **Q. PLEASE BRIEFLY SUMMARIZE YOUR TESTIMONY.**

10 A. The market for utility securitization financing is not a 100% efficient  
11 market and therefore it is important that the Commission or Public  
12 Staff have an experienced representative with co-equal authority  
13 with DEC and DEP following established best practices to act on  
14 behalf of ratepayers in the structuring and pricing of the proposed  
15 SRB financing. Without such expert representation, it is unlikely  
16 that the bonds will meet the statutory requirement of lowest storm  
17 recovery charge at the time the bonds are priced.

18 **Q. PLEASE LIST YOUR RECOMMENDATIONS FOR THE**  
19 **COMMISSION.**

20 A. In general, the Commission should modify the proposed Financing  
21 Order to allow for the Best Practices identified in my testimony as

1 well as that of witnesses Abramson, Maher and Klein, and  
2 summarized by witness Fichera. Most importantly, the Financing  
3 Order should provide that the Companies and the Public Staff,  
4 together with its independent financial advisor, have equal  
5 authority with respect to major decisions involving structuring,  
6 marketing, and pricing of the proposed SRBs and selection of  
7 underwriters and other transaction participants. Second, the  
8 Financing Order should allow for a final scheduled maturity of up  
9 to 20 years. Third, the Financing Order should contain provisions  
10 that prevent excess charges, where possible or return excess  
11 charges to the ratepayer in a timely fashion, if not. Finally, the  
12 Commission should carefully evaluate the value of including the  
13 grantor trust structure as an option in the Financing Order, given  
14 its increased complexity and the lack of any evidence supporting  
15 the value of such an option.

16 **Q. DOES THIS COMPLETE YOUR TESTIMONY?**

17 A. Yes, it does

