

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	)	HYMAN SCHOENBLUM,
Progress, LLC Issuance of Storm	)	SENIOR ADVISOR – SABER
Recovery Financing Orders	)	PARTNERS, LLC

**BEFORE THE NORTH CAROLINA UTILITIES COMMISSION**

**Docket No. E-2, Sub 1262**

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**Direct Testimony of**

**Hyman Schoenblum, Senior Advisor**

**Saber Partners, LLC**

**December 21, 2020**

**TESTIMONY OF HYMAN SCHOENBLUM**

**DECEMBER 21, 2020**

**INDEX TO DIRECT TESTIMONY OF HYMAN SCHOENBLUM**

Introduction .....	3
Conditions for a Successful Initial Public Offering of Ratepayer-Backed Bonds .....	12
Maximizing Ratepayer Benefits .....	16
Ratepayer-Backed Bond Offering Precedents Relevant to North Carolina and the Joint Petition .....	25
StructurING, Marketing and Pricing .....	30
Evaluation of Joint Petition’s Proposed Issuance Advice Letter Process.	33
Benefits of Public Staff and an Independent Financial Advisor .....	38
Need for Independent Analysis and Financial Opinions .....	42
Getting the Most Value from Underwriters and Investors from a Top Credit Rating.....	48
Summary of a Best Practices Approach .....	51

## INTRODUCTION

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

2       A.     Hyman Schoenblum, 260 Madison Avenue, Suite 8019, New York,  
3             NY 10016.

4       **Q.     WHAT IS YOUR POSITION WITH SABER PARTNERS LLC?**

5       A.     I am a Senior Advisor to Saber Partners, LLC (Saber Partners or  
6             Saber).

7       **Q.     ARE YOU SPONSORING ANY EXHIBITS?**

8       A.     Yes. I am sponsoring the following exhibits:

9             Schoenblum Exhibit 1, Barclays Technical Note: Classification of  
10            Duke Energy Florida Project Finance, LLC Bonds

11            Schoenblum Exhibit 2, Asset Securitization Report, Duke Utility Fee  
12            Securitization Sets Important Precedent, June 21, 2016

13            In addition, except as otherwise defined in this testimony, terms have  
14            the meanings assigned to them in the Glossary attached as the final  
15            exhibit to the testimonies of Public Staff witnesses Joseph Fichera  
16            and Paul Sutherland.

17       **Q.     PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND AND**  
18       **PROFESSIONAL EXPERIENCE.**



1 Decision making at Con Ed in these matters rested with the parent  
2 company's Chief Financial Officer (CFO) and Chief Executive Officer  
3 (CEO).

4 After retiring from Con Ed, I joined the Maimonides Medical Center  
5 of Brooklyn, New York, as their Vice President of Internal Audit. I  
6 retired from Maimonides in 2018.

7 **Q. WHAT SPECIFIC ACTIVITIES DID YOU UNDERTAKE IN THESE**  
8 **ROLES?**

9 A. As Vice President of Strategic Planning at Con Ed, I was the senior  
10 financial executive on the Strategic Planning Team responsible for  
11 identifying and investigating the potential value to shareholders and  
12 ratepayers of mergers and acquisitions for Con Ed. I worked with  
13 numerous investment bankers to identify merger candidates for the  
14 company. This required detailed and intensive review of operating  
15 and financial information of potential acquirees and reporting the  
16 results to senior management.

17 I played a key financial role in Con Ed's completed merger with  
18 Orange and Rockland Utilities. I was also instrumental in Con Ed's  
19 announced, but not completed, merger with Northeast Utilities, as  
20 well as other potential Con Ed mergers which were identified and  
21 evaluated, but not pursued. I also testified before the New York State  
22 (NYS) Public Service Commission and before the New Hampshire

1 Public Service Commission regarding the ratepayer impacts in the  
2 uncompleted merger with Northeast Utilities.

3 This merger activity required careful review of operating and financial  
4 risks and evaluation of the fairness opinions that the investment  
5 bankers offered in support of the proposed merger. The proposed  
6 acquisition of Northeast Utilities was rejected when we identified  
7 risks that put the fairness opinions in jeopardy.

8 I also participated in the process of identifying and evaluating other  
9 investment opportunities for Con Ed to expand into unregulated and  
10 competitive businesses, such as power generation and  
11 telecommunications. In this capacity, I worked closely with a variety  
12 of participants in the financial community including investment  
13 bankers, financial advisors, and institutional investors.

14 A key element to this activity was the evaluation of the  
15 representations of the bankers and consultants seeking to convince  
16 the company of the efficacy of the investments.

17 As deregulation in New York State began to unfold, I was appointed  
18 to head the financial team that would evaluate its impact on the  
19 company's long-term financial forecasts and to assist in the  
20 divestiture of generation assets so as to implement the deregulated  
21 energy markets.

1 As Con Ed's Vice President and Controller, I played a central role in  
2 the coordination of Con Ed's electric, gas, and steam rate cases,  
3 testifying numerous times before the NYS Public Service  
4 Commission on a variety of financial and operating matters. I testified  
5 regarding cost of capital issues as well as on a wide range of  
6 operating revenues and expenses. I assisted our rate attorneys in  
7 negotiating appropriate rate settlement agreements.

8 As Vice President and Controller, I was responsible for the  
9 preparation of the periodic financial results of Con Ed and its  
10 subsidiaries, the filing of Securities & Exchange Commission annual  
11 and quarterly reports, and reporting to the Board of Directors on a  
12 monthly basis on financial results. I was also in charge of the  
13 company's operating and capital budgets and the development of  
14 long-term financial forecasts.

15 A key element to this activity was working with the outside auditors  
16 to ensure that the "opinions" they rendered would fairly represent the  
17 results and risks inherent in the financial statements.

18 Of equal importance, was the passage of the Sarbanes-Oxley Act of  
19 2002 (SOX) which mandated that senior corporate officers certify in  
20 writing that the company's financial statements "comply with SEC  
21 disclosure requirements and fairly present in all material aspects the  
22 operations and financial condition of the issuer" (Section 302 of  
23 SOX), Officers who sign off on financial statements that they know

1 to be inaccurate are subject to criminal penalties, including prison  
2 terms. This added a heightened level of review and scrutiny to  
3 ensure that the “opinions” set forth by management were fair,  
4 reasonable and accurate.

5 As Con Ed’s Vice President and Treasurer, I participated with the  
6 Finance team in coordinating Con Ed’s capital financings  
7 (approximately \$1 billion over a number of traditional debt  
8 transactions) and cash management needs. This required intensive  
9 interaction with the company’s bankers, its senior management, and  
10 the Finance Committee of the Board of Trustees in various aspects  
11 of pricing and selling the debt issuances. I also interacted with the  
12 rating agencies, as appropriate.

13 As Treasurer, I was also one of the named fiduciaries of Con Ed’s  
14 Pension Plan responsible for administration of the plan, hiring of fund  
15 managers, and setting the appropriate investment allocations for the  
16 plan.

17 Lastly, I helped supervise Con Ed’s vast real estate portfolio and  
18 began the process of divesting significant unneeded parcels of  
19 property in midtown Manhattan. This later resulted in significant  
20 gains to Con Ed, its ratepayers, and its shareholders.

21 **Q. WHILE AT CON ED, DID YOU HAVE ANY EXPERIENCE WITH**  
22 **UTILITY SECURITIZATION/RATEPAYER-BACKED BONDS?**



1 A. As Treasurer, I assisted in a corporate review of a potential  
2 Ratepayer-Backed Bond transaction for Con Ed. Our team analyzed  
3 this financing mechanism, the market and potential to benefit Con Ed  
4 and its ratepayers. New York State did not have enabling legislation  
5 that was necessary for a AAA rating. Although there was a proposal  
6 to undertake it under the commission's existing authority, it was  
7 never tested.

8 **Q. DID YOU HAVE DIRECT EXPERIENCE WITH INSTITUTIONAL**  
9 **AND OTHER INVESTORS, EITHER AS RELATING TO CON ED IN**  
10 **PARTICULAR OR WITH REGARDS TO THE UTILITY INDUSTRY**  
11 **IN GENERAL?**

12 A. While serving in the above-mentioned positions, I played a visible  
13 leadership role in Con Ed's relationship with the Wall Street  
14 community. Along with others, I met very frequently with institutional  
15 investors, fund managers, stock and bond research analysts and the  
16 media to present Con Ed's financial position to the investment  
17 community. When adverse financial events took place, or when rate  
18 cases were being litigated and decided, I was often on the phone  
19 with investors and the financial press for many hours describing the  
20 potential implications. These activities enabled me to develop a solid  
21 relationship with the investment community, and they viewed me as  
22 a highly trustworthy individual, which inured to the benefit of the  
23 company.

1 In addition, during my employment at Con Ed, I served on many  
2 committees and task forces of the Edison Electric Institute (EEI), the  
3 electric industry's primary trade organization. I served as chairman  
4 of EEI's Accounting Principles Committee in the early 1980s.

5 I also attended many industry-wide financial conferences and  
6 discussed financial practices and policies with my peers. I was often  
7 invited to participate in panels alongside utility CFOs and CEOs to  
8 discuss financial issues affecting the utility industry, particularly in  
9 relation to the impacts of deregulation.

10 **Q. IN WHAT OTHER FINANCIAL RELATED ACTIVITIES WERE YOU**  
11 **INVOLVED?**

12 A. From 2000 to 2006, I served as a member of the Board of Trustees  
13 of Maimonides Medical Center in Brooklyn and was on their Audit,  
14 Finance, Pensions, Investments and Medical Matters Committees.  
15 In 2006, I retired from Con Ed and became the Vice President of  
16 Internal Audit at Maimonides Medical Center. In that role, I was  
17 responsible for financial and operating audits and for investigating  
18 fraud. I reported quarterly to the Audit Committee of the Board and  
19 attended Board and committee meetings. I retired from the medical  
20 center in 2018.

21 **Q. HAVE YOU HAD RECENT EXPERIENCE WITH RATEPAYER-**  
22 **BACKED BONDS?**

1       A.     Yes. In 2015, I provided direct testimony to the Florida Public Service  
2             Commission (FPSC) on the Duke Energy Florida (DEF) \$1.3 billion  
3             Ratepayer-Backed Bond transaction which refinanced the  
4             unrecovered cost of a retired nuclear power plant. I testified on a  
5             number of issues including the need for close Commission oversight  
6             after the issuance of a Financing Order and the benefits of a “Bond  
7             Team,” which included an outside financial advisor to the  
8             Commission and its staff.

9             I also participated in many aspects of the negotiations between the  
10            parties, including the FPSC staff, as well as the interactions between  
11            the Bond Team and the investment bankers hired to manage the  
12            issuance of the proposed securitized nuclear asset-recovery bonds.

13            I also had a similar role in an earlier issuance of Ratepayer-Backed  
14            Bonds in Florida for the recovery of storm costs by Florida Power and  
15            Light Company (FPL).

16       **Q.     HAVE YOU TESTIFIED IN OTHER STATES ON THIS SUBJECT**  
17             **MATTER?**

18       A.     Yes. In 2018, I submitted testimony representing Saber Partners that  
19             had been hired by the California Community Choice Association to  
20             evaluate the risks and benefits of Ratepayer-Backed Bonds to the  
21             consumers and shareholders of the California utilities.

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

2       A.     The primary purpose of my testimony is to explain why there is a  
3             need for active Commission involvement through its experts and  
4             independent advisors in the structuring, marketing and pricing of the  
5             proposed storm recovery Ratepayer-Backed Bond offering. I will  
6             distinguish between the regulatory oversight applied to Ratepayer-  
7             Backed Bonds and the oversight applicable to traditional utility debt  
8             offerings and why intense oversight of Ratepayer-Backed Bond  
9             transactions is necessary. I will show how the two types of bonds do  
10            not provide the same incentives to achieve the lowest costs to the  
11            customer and will also discuss briefly why the “lowest storm recovery  
12            charge” standard and maximum present value savings for  
13            ratepayers, based on information available through the date of  
14            pricing, are appropriate for this transaction. Lastly, I will address the  
15            importance of independent fiduciary opinions to ensure that  
16            ratepayers are receiving the maximum benefits of the Ratepayer-  
17            Backed Bond transaction, without being subjected to potential  
18            conflicts of interest.

19                           **CONDITIONS FOR A SUCCESSFUL INITIAL PUBLIC OFFERING**  
20                           **OF RATEPAYER-BACKED BONDS**

21       **Q.     WHAT MAKES A SUCCESSFUL INITIAL PUBLIC OFFERING OF**  
22             **RATEPAYER-BACKED BONDS FOR RATEPAYERS AND THE**  
23             **UTILITY?**

1       A.     First, as Witnesses Abramson and Klein point out, the North Carolina  
2             Utilities Commission (Commission) is establishing a Ratepayer-  
3             Backed Bond program for North Carolina’s investor-owned utilities  
4             and not just doing a one-off transaction. It is important that the first  
5             transaction under a new program firmly establish the policies and  
6             principles that future transactions will follow.

7             A successful Ratepayer-Backed Bond offering produces the greatest  
8             economic value from the newly created property that was authorized  
9             by the authorizing legislation, by raising funds at the lowest possible  
10            cost and least exposure to liability for ratepayers. If the measure of  
11            success were to simply sell the security created by Securitization and  
12            raise cash, regardless of the cost of the security, a “successful”  
13            Ratepayer-Backed Bond transaction would need very little attention  
14            because there are many investors that want a high-quality, high-  
15            yielding investment product. But, that would not be a successful  
16            transaction for the ratepayers responsible for paying the charges.  
17            Nor would it benefit the Commission that has given up future  
18            regulatory review of the costs and is unequivocally committed to  
19            adjusting future securitization charges, as needed.

20       **Q.     IN 2015, DEF FILED A PETITION AND RELATED TESTIMONY**  
21             **FOR THE SECURITIZATION OF \$1.3 BILLION TO RECOVER THE**  
22             **COSTS OF A RETIRED NUCLEAR PLANT. IN THAT**  
23             **PROCEEDING, THE PARTIES, INCLUDING DEF, REACHED A**

1           **STIPULATION FOR THE CREATION OF A “BOND TEAM,”**  
2           **INCLUDING AN INDEPENDENT FINANCIAL ADVISOR, TO**  
3           **WORK COLLABORATIVELY WITH THE COMMISSION STAFF**  
4           **AND DEF TOWARDS A SUCCESSFUL BOND ISSUANCE.**  
5           **NEITHER WITNESS ATKINS NOR WITNESS HEATH MAKE A**  
6           **“BOND TEAM” PROPOSAL FOR THE NORTH CAROLINA**  
7           **UTILITIES COMMISSION AND PUBLIC STAFF’S**  
8           **PARTICIPATION IN THE COMPANIES SECURITIZATION. WHAT**  
9           **IS YOUR REACTION?**

10          A.    To put it simply, I would not tamper with success. The Bond Team  
11                approach resulted in a highly praised bond offering for DEF, which  
12                yielded significant savings to ratepayers. In the DEF Ratepayer-  
13                Backed Bond transaction, I was able to observe first-hand the  
14                benefits of this collaborative process and its impact on the final  
15                results on a successful offering. True, there were instances, as in  
16                any negotiation, where the parties did not fully agree on the process,  
17                but by working collaboratively, the Bond Team was able to reach a  
18                necessary consensus.

19                I believe that the Commission, Public Staff, their independent  
20                advisors and the Companies need to be integral and equal partners  
21                in all aspects of the process. All of these parties need to play an  
22                active and visible role in presenting the proposed storm recovery  
23                bonds to the capital markets.

1 In my view, the process needs to be viewed by investors and all  
2 participants as a joint, collaborative process, so that investors and  
3 ratepayers are assured that they are well protected.

4 Any traditional utility financing will have meaningful regulatory  
5 oversight, and the ratemaking process generally provides that  
6 oversight on an ongoing basis. In the case of this storm recovery  
7 Ratepayer-Backed Bond financing, however, the constraints  
8 imposed by the enabling statute appear to prohibit “after-the-fact”  
9 reviews for prudence in evaluating any aspect of the structuring,  
10 marketing and pricing of these bonds. In addition, the State also  
11 pledges not to take any action that puts the repayment of the storm  
12 recovery bonds, and related interest, at risk.

13 In light of these after-the-fact ongoing constraints, Commission  
14 oversight at the outset needs to be expanded to include Commission  
15 and Public Staff involvement critical to the maintenance of the credit  
16 value. There needs to be an understanding by investors that the  
17 regulator and ratepayers fully support all aspects of the offering and  
18 that there is likely little, if any, “political” risk to the storm recovery  
19 bond. For example, if the record clearly shows that the Commission  
20 and Public Staff fully supported and approved all aspects of the  
21 offering, it becomes less likely that future elected officials or  
22 appointees at the Commission or Public Staff will attempt to  
23 challenge the bond structure or the storm recovery charge.

1 In light of their responsibilities relating to storm recovery bonds, the  
2 Commission and Public Staff need to be more involved in the  
3 structuring, marketing, and pricing process so as to be thoroughly  
4 informed, able to assimilate the impact of structuring changes, and  
5 to understand the decisive elements included in determining the  
6 pricing guidance. To be effective in meeting its mandate in this  
7 financing, the Commission needs greater information and  
8 involvement, not less. Existing legislation directs Public Staff to be  
9 an integral voice in matters affecting ratepayers and to provide the  
10 Commission with the necessary information and expertise to make  
11 informed decisions.

12 It is my opinion that the Financing Order should provide for the  
13 creation of a Bond Team which will ensure that the Commission, as  
14 well as Public Staff and their respective financial advisors, will be  
15 directly and visibly involved throughout the structuring, marketing,  
16 and pricing process.

17 **MAXIMIZING RATEPAYER BENEFITS**

18 **Q. HOW CAN THE BENEFITS TO RATEPAYERS BE MAXIMIZED?**

19 A. One of the hallmarks of Ratepayer-Backed Bond transactions is that  
20 the financing orders are irrevocable: the state agrees never to impair  
21 the right of the bondholders to the special charge as it is adjusted  
22 periodically to repay the bonds in full. This is a key feature in helping



1 to secure a AAA rating. But an irrevocable Financing Order also  
2 forfeits the Commission’s traditional retrospective review function  
3 after the bonds are issued. This is why it is essential for the  
4 Commission, Public Staff, and the Companies to create a  
5 collaborative, cooperative process. The best way to protect  
6 ratepayers is to provide for a clear standard to evaluate proposals  
7 and for Commission approval of all future decisions affecting  
8 ratepayers before they are made final when the bonds are issued.  
9 The Commission should not make final decisions based on draft  
10 language submitted as exhibits to the Joint Petition or exhibits to  
11 testimony, but on final terms and conditions. For this to be a  
12 meaningful review and decision process, it cannot be restricted or  
13 restrained in terms of time and consideration. By adopting the “best  
14 practices” procedures summarized in this testimony, the  
15 Commission will be “at the table” for all negotiations affecting  
16 ratepayers in advance of any decisions affecting such ratepayers.  
17 The Commission and the Companies should work in a collaborative  
18 process when negotiating with each other and with underwriters and  
19 investors.

20 **Q. DOES RATEMAKING FOR RATEPAYER-BACKED BONDS**  
21 **FUNDAMENTALLY DIFFER FROM STANDARD UTILITY**  
22 **RATEMAKING?**



1           However, this very strong incentive is not present with regard to  
2           Ratepayer-Backed Bonds. As described above, the Commission's  
3           hands are severely constrained. Unlimited post-issuance reviews are  
4           prohibited because such reviews would threaten the viability of the  
5           AAA rating. Thus, appropriate safeguards need to be implemented  
6           at the outset of the process.

7           Furthermore, while the Companies have a general business interest  
8           to keep overall customer rates low, the utilities will have no obligation  
9           to repay the storm-recovery bonds and will have no responsibility to  
10          pay any of the costs.

11          The Companies will have a small capital investment in the AAA  
12          finance subsidiary which they are guaranteed to receive back at the  
13          end of the transaction through storm recovery charges. All other  
14          costs will be borne directly by the ratepayers, and the traditional  
15          regulatory checks and balances will be missing.

16          In fact, the highest priority of the Companies in this transaction will  
17          be to get the issuance done quickly, with cost taking a lower priority.

18          Getting the issuance done quickly will be the highest priority of the  
19          Underwriters as well.

20          **Q.    IS THERE ANOTHER MAJOR REASON WHY COMMISSION AND**  
21          **PUBLIC STAFF INVOLVEMENT IS NECESSARY?**

1 A. Yes. Generally, the interests of Underwriters are fundamentally  
2 adverse to the interests of ratepayers. Underwriters will want to  
3 negotiate for relatively high rates of interest so that the bonds can be  
4 sold with the least effort, satisfying the desires of their investors for  
5 high interest rates relative to competing investments. Underwriters  
6 will also negotiate aggressively for the highest possible underwriting  
7 fees. There is nothing inherently wrong about this process. It is part  
8 of a “market system” where each participant acts in his or her own  
9 economic interest. But, because 100 percent of the economic burden  
10 will be borne by the ratepayers, it is wise to keep this in mind when  
11 negotiating Underwriter fees, the marketing plan, and final prices  
12 with Underwriters and investors. Deferring to the Underwriters’  
13 “professional judgement,” as Witnesses Atkins and Heath suggest,  
14 is not always in the best interest of ratepayers who are paying all of  
15 the bills.

16 **Q. ARE THESE THE PRIMARY REASONS FOR THE COMMISSION**  
17 **AND PUBLIC STAFF TO BE INVOLVED IN ALL STEPS OF THE**  
18 **SECURITIZATION PROCESS BEFORE THE STORM RECOVERY**  
19 **BONDS ARE ISSUED?**

20 A. Yes. The only prudent and reasonable approach, with ample  
21 precedent in other Ratepayer-Backed Bond transactions, is direct  
22 Commission and Public Staff involvement in all the steps of the  
23 process. That will provide the Commission with the essential

1 information to approve this storm recovery bond issuance as  
2 unequivocally protecting ratepayers' interests and help achieve the  
3 lowest storm recovery charges.

4 The Commission should be actively engaged in receiving from Public  
5 Staff and the Companies market pricing information, and in creating  
6 an investor marketing strategy and outreach to assure the  
7 Commission's thorough understanding and effective decision  
8 making in a timely fashion. An inefficient transaction and needlessly  
9 higher storm recovery charges could result from a lack of  
10 Commission oversight. Active participation with the Public Staff and  
11 its advisors is the way to ensure proper ratepayer protection.

12 **Q. IS IT IMPORTANT TO HAVE RATEPAYER PROTECTIONS IN**  
13 **THE FINANCING ORDER AND THE BOND TRANSACTION**  
14 **DOCUMENTS AS WELL?**

15 A. Yes. In a complex legal arrangement such as a Ratepayer-Backed  
16 Bond transaction, terms, conditions, representations and warranties  
17 concerning all contracts need to be evaluated from an arm's length,  
18 dispassionate perspective. The risks, costs, and liabilities should be  
19 independently evaluated, and policies independently developed.

20 From the Commission's and ratepayers' perspective, the storm  
21 recovery bonds will be issued under an irrevocable Financing Order  
22 that cannot be changed by the Commission after the bonds have  
23 been issued. The term of the bonds could be 15-20 years or longer.

1 In addition, the Companies and their respective Special Purpose  
2 Entity (SPE) issuers will enter into servicing agreements under which  
3 the sponsoring utility will bill, collect and remit the storm recovery  
4 charge to a bond trustee for the account of the SPE issuer. Like any  
5 other contract for services, that servicing agreement will have  
6 provisions concerning performance, care, liabilities, and indemnities.  
7 All these could affect ratepayers at any time during the life of the  
8 storm recovery bonds. Yet, the servicing agreements are essentially  
9 between affiliated parties with all the liabilities associated with the  
10 agreements falling to ratepayers under the storm recovery charge  
11 and the true-up mechanism.

12 Saber Partners strongly believes regulatory oversight should be  
13 preserved concerning the servicing agreements and other  
14 transaction documents for the life of the storm recovery bonds. With  
15 an increasing number of mergers in the electric industry, it is  
16 important for the Commission to look beyond the next few years and  
17 put in place ratepayer protections that survive even in the case of a  
18 merger and new management. Ever-changing corporate structures  
19 need scrutiny by the Commission since future owners may have a  
20 different attitude about this transaction 10-15 years or longer into the  
21 future.

22 **Q. IN YOUR VIEW, SHOULD THE COMMISSION GIVE THE**  
23 **COMPANIES BROAD FLEXIBILITY TO ESTABLISH THE FINAL**



1           **ADVICE TO THEM ON THE SAME RATEPAYER-BACKED**  
2           **BONDS IN THIS CASE, AND IF SO, WHY WOULD THIS POSE A**  
3           **CONFLICT?**

4           A.    I do not know definitively. However, Witnesses Atkins and Heath,  
5           who are testifying on behalf of the Companies, have proposed that  
6           these securitized storm recovery bonds be sold in a negotiated sale  
7           through a group of pre-selected Underwriters. In response to PS DR  
8           2-2(h), Witness Heath states: “For the vast majority of utility  
9           securitizations not issued by municipal entities, with only a very few  
10          exceptions, it is the market practice for the structuring advisor to also  
11          serve as a lead underwriter.” For the reasons outlined in my  
12          testimony above, a conflict of interest arises whenever the same firm  
13          provides consulting advice to an issuer and then serves as the lead  
14          Underwriter for the issuer on the same transaction.

15          In addition, many of the largest Underwriters in the country have also  
16          been utilized as both an Underwriter and a Bookrunning Manager in  
17          other Ratepayer-Backed Bond issuances. As such, there is a strong  
18          possibility that one of the pre-selected Underwriters may also  
19          become a Bookrunning Manager.

20          In fact, given Witness Atkins’ strong historical ties with Morgan  
21          Stanley, I would not be surprised if Morgan Stanley were conflicted  
22          in this manner. In my view, this represents a conflict of interest and  
23          should be avoided, if possible.



1 In a typical corporate bond issuance, the issuer often states in the  
2 prospectus, under the heading "Underwriters (Conflict of Interest)",  
3 that some of the Underwriters of the issuance also provide financial  
4 advisory services for which they receive payment rather than simply  
5 disclosing a conflict of interest.

6 In fact, as mentioned above, Witness Heath in response to Data  
7 Request PS-DR 2-2(h) states that, from his perspective, the  
8 structuring advisors "due to their familiarity with, and their experience  
9 participating in the regulatory testimony and interrogatory process,  
10 are often in the best position to serve as lead underwriter of  
11 Securitization bonds". It is obviously convenient to have the advisor  
12 also act as Underwriter, but I question the appropriateness of this  
13 arrangement. From my perspective, we need to question whether the  
14 lead Underwriters will have the proper and necessary incentives in  
15 this transaction.

16 I understand that under North Carolina storm recovery bond statute,  
17 the Commission will not have the ability to assess this Ratepayer-  
18 Backed Bond transaction on a post-issuance basis. Thus, pre-  
19 issuance guidelines are definitely advisable.

20 **RATEPAYER-BACKED BOND OFFERING PRECEDENTS**  
21 **RELEVANT TO NORTH CAROLINA AND THE JOINT PETITION**

22 **Q. REGARDING RATEPAYER-BACKED BONDS ISSUED IN OTHER**  
23 **STATES, HAVE COMMISSIONS BEEN ACTIVELY INVOLVED IN**

1                   **THE STRUCTURING, MARKETING, AND PRICING OF THESE**  
2                   **TRANSACTIONS?**

3           A.     Yes. Commissions in Florida, Texas, New Jersey, West Virginia,  
4                   Ohio, and Louisiana have been actively involved in the structuring,  
5                   marketing and pricing of Ratepayer-Backed Bonds. The degree of  
6                   involvement and success has varied, but involvement in a post-  
7                   financing order/pre-bond issuance review process is consistent.

8                   The Texas Commission has had one of the most active post-  
9                   financing order participation regimes, particularly in the first six  
10                  Ratepayer-Backed Bond offerings that it approved. Witness  
11                  Rebecca Klein, former Chair of the Public Utility Commission of  
12                  Texas (PUCT), testifies at length about her positive experiences  
13                  regarding the involvement of the PUCT and its financial advisor in  
14                  the Securitization process.

15                  Florida and West Virginia have also been very successful in  
16                  protecting ratepayers' interests through their financing orders that  
17                  were based on "best practices."

18                  With regards to North Carolina, since this will be the first Ratepayer-  
19                  Backed Bond transaction under the State's storm recovery bond  
20                  statute, it is certainly advisable, even critical, that the Commission  
21                  and the Public Staff have active involvement in all aspects of the  
22                  transaction.

1       **Q.     CAN YOU DESCRIBE THE RESULTS THAT WERE ACHIEVED**  
2       **BY THE ACTIVE INVOLVEMENT OF COMMISSIONS IN THE**  
3       **STRUCTURING, MARKETING, AND PRICING OF RATEPAYER-**  
4       **BACKED BONDS?**

5       A.     Yes. Three Ratepayer-Backed Bond transactions illustrate the  
6       results that can be achieved by an active and involved commission  
7       with an entity focused on ratepayer interests in a joint decision-  
8       making relationship in these activities.

9       In 2016, DEF issued Ratepayer-Backed Bonds to recover the costs  
10      of its retired nuclear power plant. DEF proposed and negotiated a  
11      settlement with the Commission staff and intervenors that allowed its  
12      investors to recover the costs of its retired plant and at the same time  
13      provide more than \$680 million in net present value benefits to  
14      ratepayers. Clearly, a win-win. The capital markets viewed this  
15      transaction in a positive manner, further protecting ratepayers from  
16      increased capital costs and allowing DEF to raise debt capital in the  
17      future at reasonable rates. The markets were especially positive  
18      about the net benefits of the transaction's longest maturities, which  
19      generally carry the highest rates. The FPSC, DEF, and Saber worked  
20      collaboratively, as joint decision-makers on a Bond Team, to make  
21      this a success. The FPSC staff and the Florida Office of Public  
22      Counsel specifically acknowledged Saber's work on the Bond Team  
23      with regards to its development of "best practices" and the excellent

1 pricing of the bonds which yielded significant savings to the Florida  
2 ratepayers.

3 In September 2005, Public Service Electric and Gas Company of  
4 New Jersey sponsored the issuance of \$102 million of Ratepayer-  
5 Backed Bonds. Saber served as financial advisor to the New Jersey  
6 Board of Public Utilities (BPU), and Credit Suisse (CS) was the lead  
7 underwriter. Normally this transaction might have been difficult to sell  
8 because of its small size relative to other competing investments.  
9 However, the extensive marketing of those bonds conducted by CS,  
10 Barclays and M.R. Beal, with Saber's active participation, led to  
11 unprecedented low pricing spreads, despite the disadvantage of  
12 relatively small tranche sizes.

13 In December 2005, CenterPoint Energy of Texas initially offered  
14 \$1.2 billion of securitized Ratepayer-Backed Bonds to the market.  
15 Saber was the independent financial advisor to the PUCT and was,  
16 as reflected in the PUCT's Financing Order, granted joint decision-  
17 making responsibility with the sponsoring utility. CS was one of the  
18 bookrunning Underwriters. In that case, the large size of the  
19 transaction, coupled with the timing of the issuance at the end of the  
20 year (which traditionally is not a good time to sell securities), posed  
21 special challenges. Nevertheless, the Ratepayer-Backed Bonds  
22 received worldwide investor demand at record-low credit spreads  
23 under market conditions at the time of the offering. The transaction

1 was increased to \$1.85 billion, with over one-third of the bonds being  
2 sold to foreign investors. This was the first time a significant portion  
3 of an issue of Ratepayer-Backed Bonds ever had been marketed to  
4 foreign investors.

5 **Q. THE NORTH CAROLINA SECURITIZATION STATUTE INCLUDES**  
6 **A “LOWEST STORM RECOVERY CHARGE” REQUIREMENT. IN**  
7 **YOUR VIEW, IS THAT STANDARD APPROPRIATE FOR**  
8 **RATEPAYER-BACKED BOND TRANSACTIONS?**

9 A. Absolutely. The proceeds of a bond issuance are cash dollars.  
10 Issuers want to raise the maximum amount of dollars at the lowest  
11 possible overall cost. Underwriters often have a vested interest in  
12 urging the use of a standard of “reasonable cost” because  
13 “reasonable” covers a range of outcomes. For any long-term  
14 financing, that range might represent millions of dollars in extra costs.  
15 One might choose to use a reasonable cost standard to reimburse a  
16 doctor, where there are differences in both the type and quality of  
17 care. However, there is no reason to pay any more for a bond issue  
18 than is necessary especially if the ratepayers are “stuck with bill”.  
19 With a “lowest storm recovery charge” standard, the emphasis is on  
20 eliminating waste and inefficiency which otherwise might occur under  
21 a “reasonable cost” and maximize ratepayer savings by also  
22 including the impact of the “time value of money”.

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**STRUCTURING, MARKETING AND PRICING**

**Q. PLEASE DESCRIBE WHAT IS MEANT BY THE PHRASE “STRUCTURING, MARKETING AND PRICING” OF RATEPAYER-BACKED BONDS, AND WHY DOES IT MATTER TO RATEPAYERS?**

A. As described in the testimony of Witnesses Sutherland and Fichera: “Structuring” refers to the legal documentation and the delineation of rights, duties, covenants, responsibilities, and actions of various parties to the transaction under current and anticipated market conditions affecting the bonds and the interaction with investors. Structuring also refers to the specific payment schedule for the bonds, the maturity, aggregation of cash flows in tranches (like a series) within the overall maturity, redemption features and the method and frequency of payment. “Marketing” refers to the communication of the terms, conditions, credit and investment thesis to the Underwriters and potential investors in preparation for pricing. “Pricing” refers to the actual interest rate and costs assigned to the bonds in exchange for cash. Generally, the bonds are first sold to a group of banks (underwriters) who resell the bonds to investors.

**Q. THE NORTH CAROLINA STORM RECOVERY BOND STATUTE ENVISIONS THAT THE “STRUCTURING AND PRICING” OF**

1           **STORM RECOVERY BONDS WILL ACHIEVE THE “LOWEST**  
2           **STORM RECOVERY CHARGES” AT THE TIME THE STORM**  
3           **RECOVERY BONDS ARE PRICED. IN YOUR VIEW, SHOULD**  
4           **ANY ADDITIONAL ACTIONS BE TAKEN INTO ACCOUNT IN**  
5           **DETERMINING WHETHER STORM RECOVERY BONDS**  
6           **ACHIEVE THE “LOWEST STORM RECOVERY CHARGES” AT**  
7           **THE TIME THE STORM RECOVERY BONDS ARE PRICED?**

8           A.    Yes. When commissions in other states have applied a “lowest  
9           securitized charges” standard, they often have required to take into  
10          account not only decisions related to “structuring and pricing,” but  
11          also decisions related to “marketing” the Ratepayer-Backed Bonds.  
12          Examples include the 2016 Florida transaction for DEF, the 2007  
13          Florida transaction for FPL, the 2007 and 2009 West Virginia  
14          transactions for Monongahela Power Company and for The Potomac  
15          Edison Company, and the three Texas transactions described in  
16          Witness Klein’s testimony. I recommend that the Commission’s  
17          Financing Order in this proceeding take into account not only  
18          decisions related to “structuring and pricing,” but also decisions  
19          related to “marketing” the storm recovery bonds.

20          **Q.    IN YOUR VIEW, SHOULD THE “LOWEST STORM RECOVERY**  
21          **CHARGE” STANDARD BE APPLIED ONLY BASED ON**  
22          **EXPECTATIONS AS OF THE DATE THE FINANCING ORDER IS**  
23          **ISSUED, OR SHOULD THE “LOWEST STORM RECOVERY**

1           **CHARGE” STANDARD ALSO BE APPLIED BASED ON ACTUAL**  
2           **FACTS THROUGH THE DATE ON WHICH STORM RECOVERY**  
3           **BONDS ARE PRICED?**

4           A.     In my view, the “lowest storm recovery charge” standard should be  
5           applied based on actual facts through the date on which storm  
6           recovery bonds are priced.

7           **Q.     IN YOUR VIEW, DOES N.C. GEN. STAT. § 62-172 AUTHORIZE**  
8           **OR DIRECT THE COMMISSION TO INCLUDE IN ITS STORM**  
9           **RECOVERY BOND FINANCING ORDERS A REQUIREMENT**  
10          **THAT THE “LOWEST STORM RECOVERY CHARGE”**  
11          **STANDARD BE APPLIED BASED ON ACTUAL FACTS**  
12          **THROUGH THE DATE ON WHICH STORM RECOVERY BONDS**  
13          **ARE PRICED?**

14          A.     Yes. This is not among the items specifically required by the statute  
15          to be included in storm recovery bond Financing Orders. However,  
16          the statute directs that storm recovery bond financing orders are also  
17          to include “[a]ny other conditions not otherwise inconsistent with this  
18          section that the Commission determines are appropriate.” In my  
19          view, it is “appropriate” for the Commission’s Financing Order in this  
20          proceeding to include a requirement that the “lowest storm recovery  
21          charge” standard be applied based on actual facts through the date  
22          on which storm recovery bonds are priced. In addition, for the  
23          reasons described above, in my view, it also is appropriate for the



1 Commission's Financing Order in this proceeding to require the  
2 "lowest storm recovery charge" determination to take into account  
3 not only the "structuring and pricing" but also the "marketing" of storm  
4 recovery bonds.

5 **EVALUATION OF JOINT PETITION'S PROPOSED ISSUANCE**  
6 **ADVICE LETTER PROCESS**

7 **Q. DOES THE FORM OF FINANCING ORDER PROPOSED BY THE**  
8 **COMPANIES JOINT PETITION UNAMBIGUOUSLY REQUIRE**  
9 **THAT THE COMPANIES INCLUDE IN THEIR ISSUANCE ADVICE**  
10 **LETTERS A "LOWEST STORM RECOVERY CHARGE"**  
11 **CONFIRMING CERTIFICATION, BASED ON INFORMATION**  
12 **AVAILABLE THROUGH THE DATE ON WHICH STORM**  
13 **RECOVERY BONDS ARE PRICED?**

14 A. I believe the proposed form of Financing Order is ambiguous as to  
15 whether the Companies' Issuance Advice Letters must include a  
16 "lowest storm recovery charge" confirming certification, based on  
17 information available through the date on which storm recovery  
18 bonds are priced.

19 On the one hand, Finding of Fact 33 in the proposed form of  
20 Financing Order states:

21 Because the actual structure and pricing of the Storm  
22 Recovery Bonds are unknown as of the issuance of this  
23 Financing Order, following determination of the final  
24 terms of the Storm Recovery Bonds and before  
25 issuance of the Storm Recovery Bonds, DEP will file

1 with the Commission for each series of Storm  
2 Recovery Bonds, an IAL, as well as a form of True-Up  
3 Adjustment Letter<sup>14</sup> (“TUAL,” and together with the  
4 IAL, the “IAL/TUAL”) in the forms attached hereto as  
5 Appendices B and C. The initial Storm Recovery  
6 Charges and the final terms of the Storm Recovery  
7 Bonds described in the IAL/TUAL will be final unless  
8 before noon on the third business day after pricing the  
9 Commission issues an order finding that the proposed  
10 issuance does not comply with the Standards of this  
11 Financing Order in this Finding of Fact No. 33. The  
12 “Standards of this Financing Order” are: . . . 7) the  
13 structuring and pricing of the Storm Recovery Bonds,  
14 including the issuance of SRB Securities, resulted in  
15 the lowest Storm Recovery Charges consistent with  
16 market conditions at the time the Storm Recovery  
17 Bonds are priced and the terms set forth in this  
18 Financing Order.

19 The form of Issuance Advice Letter attached as Appendix C to the  
20 form of Financing Order attached as Exhibit C to the Joint Petition  
21 states:

22 The Financing Order requires the Company to confirm,  
23 using the methodology approved therein, that the  
24 actual terms of the SRB Notes and Storm Recovery  
25 Bonds result in compliance with the standards set forth  
26 in the Financing Order. These standards are:

27 \* \* \*

28 7. the structuring and pricing of the Storm  
29 Recovery Bonds, including the issuance of SRB Notes,  
30 resulted in the lowest Storm Recovery Charges  
31 consistent with market conditions at the time the Storm  
32 Recovery Bonds are priced and the terms set forth in  
33 this Financing Order.

34 The form of Company Certification included as Attachment 8 to  
35 Appendix C states:

36 Based on the statutory criteria and procedures, the  
37 record in this proceeding, and other provisions of this

1 Financing Order, DEP certifies the statutory  
2 requirements for issuance of a financing order and  
3 Storm Recovery Bonds have been met, specifically  
4 that the issuance of the SRB Notes and underlying  
5 Storm Recovery Bonds on behalf of DEP and the  
6 imposition and collecting of storm recovery charges  
7 authorized by this Financing Order provide quantifiable  
8 benefits to customers of DEP as compared to the costs  
9 that would have been incurred absent the issuance of  
10 Storm Recovery Bonds and that the structuring and  
11 pricing of the SRB Notes and underlying Storm  
12 Recovery Bonds issued on behalf of DEP result in the  
13 lowest storm recovery charges payable by the  
14 customers of DEP consistent with market conditions at  
15 the time such SRB Notes and underlying Storm  
16 Recovery Bonds are priced and the terms set forth in  
17 the Financing Order.

18 On the other hand, page 56 of the proposed form of Financing Order  
19 states: “Finally, the combined IAL/TUAL shall include certifications  
20 from DEP, **if required**, that the structuring and pricing of the Storm  
21 Recovery Bonds achieved the **Statutory Cost Objectives.**”  
22 Similarly, Finding of Fact 11 states: “Finally, the combined IAL/TUAL  
23 shall include certifications from DEP **if required**, that the structuring,  
24 pricing and Financing Costs of the Storm Recovery Bonds achieved  
25 the **Statutory Cost Objectives.**” (emphasis added) This language  
26 suggests that these confirming certifications from DECF and DEP  
27 might not be required.

28 In addition, page 9 of the proposed form of Financing Order defines  
29 “Statutory Cost Objectives” to mean, collectively: “(i) the proposed  
30 issuance of Storm Recovery Bonds and the imposition of Storm  
31 Recovery Charges will provide quantifiable benefits to customers as

1 compared to the costs that would have been incurred absent the  
2 issuance of Storm Recovery Bonds and (ii) the structuring and  
3 pricing of the Storm Recovery Bonds are **reasonably expected** to  
4 result in the lowest Storm Recovery Charges consistent with market  
5 conditions at the time the Storm Recovery Bonds are priced and the  
6 terms set forth in this Financing Order.” (emphasis added). This  
7 language suggests that any required confirming certifications from  
8 the Companies might be based on their reasonable expectations as  
9 of the date of the Financing Order, rather than on information  
10 available through the date on which Storm Recovery Bonds are  
11 priced.

12 I recommend that the language on page 9, in Finding of Fact 11, and  
13 on page 56 be revised to be clear in requiring that the Companies  
14 include in their Issuance Advice Letters a “lowest storm recovery  
15 charge” confirming certification, based on information available  
16 through the date on which storm recovery bonds are priced.

17 **Q. ARE UNDERWRITERS AND INVESTORS COOPERATIVE IN**  
18 **ACHIEVING THE LOWEST SECURITIZED CHARGES?**

19 A. It varies. Some are more cooperative than others. Fundamentally,  
20 Underwriters have an inherent conflict of interest in determining the  
21 price of the bonds for issuers. Underwriters by definition, will be the  
22 initial purchasers of the bonds, generally purchasing the bonds from  
23 the issuer at an agreed discount and then reselling the bonds to

1 investors at face value. The higher the interest rate, the easier it will  
2 be for the Underwriters to resell the bonds at face value. Therefore,  
3 it is in the Underwriters' economic interest to get a higher interest  
4 rate to make it easier to induce their customers, the investors, to buy  
5 the bonds. Investors also want as high an interest rate as possible.

6 **Q. DOES ATTEMPTING TO ACHIEVE A LOWEST SECURITIZATION**  
7 **CHARGE STANDARD SOMETIMES CREATE MORE COSTS FOR**  
8 **RATEPAYERS IN CERTAIN RESPECTS?**

9 A. No. Pursuing a lowest Securitization charge standard might require  
10 transaction participants to work harder, and possibly a bit longer, but  
11 not necessarily at a higher net economic cost. Working harder for the  
12 ratepayer saves money. Among the on-going transaction costs, the  
13 greatest economic cost to ratepayers is the interest rate on the bonds  
14 which ratepayers will be paying for up to 15-20 years or more. This  
15 dwarfs most of the up-front issuance expenses.

16 The approval standard utilized by the Commission in this type of  
17 transaction with its very significant costs, needs to be a much  
18 stronger standard than "reasonable cost." Because the incentives  
19 between the utility and ratepayer are not clearly aligned, and full  
20 after-the-fact prudency reviews are not possible, the Commission's  
21 standard should be "lowest storm recovery charge" and maximum  
22 present value savings for ratepayers. Without involvement in real  
23 time by Public Staff and its advisor's expertise, there will be no way

1 for the Commission to have confidence that the transaction was  
2 priced at the lowest interest rate possible under then-current market  
3 conditions. Every dollar of costs in this Ratepayer-Backed Bond  
4 transaction is a ratepayer dollar. There is no material risk to the  
5 utilities' shareholders given the robust true-up mechanism combined  
6 with the state pledge of non-interference.

7 This is one reason why extra care needs to be taken, in cooperation  
8 with the Companies, in selecting experienced and responsive  
9 transaction participants. It is essential to put together a team which  
10 shares similar objectives and a commitment to excellence, which can  
11 provide economies of scale, and which is responsive to competitive  
12 pressures and economic incentives. This will build investor  
13 confidence in the bond offering and customer confidence in the final  
14 decision made by the Commission to allow the bond offering to  
15 proceed using the issuance advice letter process.

16 **BENEFITS OF PUBLIC STAFF AND AN INDEPENDENT**  
17 **FINANCIAL ADVISOR**

18 **Q. HOW WILL ACTIVE INVOLVEMENT OF THE COMMISSION AND**  
19 **THE PUBLIC STAFF WITH ITS FINANCIAL ADVISOR IN THE**  
20 **STRUCTURING, MARKETING, AND PRICING OF THESE**  
21 **RATEPAYER-BACKED BONDS AFTER ISSUANCE OF THE**  
22 **FINANCING ORDER ENSURE A “LOWEST STORM RECOVERY**

1                   **CHARGE” TRANSACTION UNDER MARKET CONDITIONS AT**  
2                   **THE TIME OF PRICING?**

3           A.     Because the Financing Order will be irrevocable, the interests of  
4                   ratepayers need to be fully represented with proper economic  
5                   incentives at every step of the process. The Companies and their  
6                   agents have specific interests in the outcome of this transaction: to  
7                   raise the full authorized amount in the shortest time possible and with  
8                   the least possible effort. Those interests might diverge in some  
9                   material respects from the interests of ratepayers who will bear the  
10                  full economic burden of the transaction for 15-20 years or more.  
11                 Nevertheless, a cooperative and collaborative effort can achieve  
12                 common goals.

13                 In this case, many decisions affecting ratepayer costs and risks  
14                 cannot be known until after a financing order has been issued. The  
15                 Companies have proposed a process that would provide important  
16                 information to the Commission only by the issuance of advice letters,  
17                 delivered after the structuring, marketing and pricing process is  
18                 complete. This is inadequate for the Commission to make an  
19                 informed decision. Without having been at the “negotiating table” in  
20                 the first instance, it is impossible to have adequate information to  
21                 make an informed decision to either stop or let the transaction  
22                 proceed with full confidence that all appropriate efforts have been  
23                 undertaken. “At the negotiating table” is different from being outside

1 the room and getting reports and information from the utility on its  
2 discussions after the fact.

3 As discussed above in this testimony, Underwriters who will provide  
4 much of the market information concerning the upcoming sale of the  
5 securitized storm recovery bonds will have no fiduciary obligation to  
6 DEC/DEP, the Commission, or ratepayers. They do not have to work  
7 in the best interests of the ratepayers and are permitted to act in their  
8 own financial interest. It is evident in the standard underwriting  
9 agreement used in these and other transactions which explicitly  
10 states that there is no fiduciary relationship and often states that any  
11 review by the Underwriters of the transaction will be performed solely  
12 for the benefit of the Underwriters and shall not be on behalf of the  
13 Issuer or utility. (See also the testimony of Witness Brian Maher on  
14 the issue of fiduciary obligation.)

15 Only by having the Commission and the Public Staff and its financial  
16 advisor involved at every step after issuance of the Financing Order,  
17 and by working together with the Companies as joint decision makers  
18 during all critical stages, can we ensure that the lowest storm  
19 recovery charges to ratepayers is achieved.

20 **Q. CAN YOU EXPAND ON WHY IT IS NECESSARY FOR THE**  
21 **COMMISSION TO ENSURE THE CONTINUING ACTIVE**  
22 **INVOLVEMENT OF PUBLIC STAFF AND ITS FINANCIAL**  
23 **ADVISOR AFTER ISSUANCE OF THE FINANCING ORDER?**



1           A.       Yes. Both the Commission, Public Staff and their respective staffs  
 2                     have many years of experience in reviewing and approving the  
 3                     issuance of traditional utility debt and equity securities. Generally,  
 4                     regulatory Commissions and ratepayer advocates do not have  
 5                     experience in reviewing and approving securitized Ratepayer-  
 6                     Backed Bonds where the utility may have little or no incentive to  
 7                     minimize the rate of interest or the costs of issuance, or to offer  
 8                     reasonable representations, warranties and covenants for the  
 9                     benefit of ratepayers. In this case, as specifically authorized by N.C.  
 10                    Gen. Stat. § 62-172(n), Public Staff has decided to supplement its  
 11                    experience with that of an experienced and independent financial  
 12                    advisor.

13                   The Companies, as well, have little or no experience in issuing  
 14                   securitized Ratepayer-Backed Bonds. Their sister utility, DEF, has  
 15                   done one transaction. This heightens the benefits of a continuing and  
 16                   collaborative process with the Commission, Public Staff and its  
 17                   experienced financial advisor after the financing order is issued.  
 18                   Moreover, Witness Heath has testified that the Companies financial  
 19                   advisors have no fiduciary relationship with the Companies, so it is  
 20                   more difficult to evaluate the advice and information given about a  
 21                   subject with which they are not generally familiar, and about which  
 22                   their financial advisors may be conflicted.

1 With the help of experts intimately familiar with the legal and financial  
2 specifics and nuances of Ratepayer-Backed Bonds, and with a  
3 fiduciary duty to the Commission, Public Staff, and ratepayers, the  
4 Commission can ensure that ratepayers' interests are protected and  
5 that the Companies receive the proceeds of a successful offering. An  
6 actively involved and independent financial advisor to the  
7 Commission or to Public Staff, who has an implicit fiduciary  
8 relationship with the Commission, will add tremendously to the  
9 Commission's ability to reach this goal.

10 For example, corporations and financial advisory firms interface  
11 regularly with public capital markets, whereas utility commissions  
12 and Public Staff do not. Public Staff's financial advisor for the  
13 proposed storm recovery bonds, Saber Partners, is intimately  
14 familiar with the structuring, marketing, and pricing of Ratepayer-  
15 Backed Bonds, as well as with the participants in the corporate,  
16 asset-backed securities and international securities markets. Saber  
17 Partners will be able to provide critical information and perspective  
18 to the Commission to discharge its duties and to assist the  
19 Companies.

20 **NEED FOR INDEPENDENT ANALYSIS AND**  
21 **FINANCIAL OPINIONS**

22 **Q. BASED ON YOUR EXPERIENCE, WHY SHOULD THE**  
23 **COMMISSION NOT SIMPLY RELY ON THE "ISSUANCE ADVICE**

1           **LETTER” INCLUDING THE CERTIFICATION FROM THE**  
2           **COMPANIES THAT THE PRICING OF THE STORM RECOVERY**  
3           **BONDS RESULTED IN THE LOWEST STORM RECOVERY**  
4           **CHARGE, AND WHY IS THAT NOT SUFFICIENT AS AN**  
5           **INDICATOR OF A SUCCESSFUL TRANSACTION?**

6           A.    From my perspective, issuance advice letters may not always be  
7           conflict free. As I described above, there is an inherent conflict of  
8           interest on the part of utility and Underwriters in pricing any bonds.  
9           Based upon my experience as the Treasurer of a very large utility, I  
10          realized very quickly that Underwriters of our debt issuances weren’t  
11          necessarily “on the same page” as we, the issuers, were. We shared  
12          many of the same goals concerning the execution of an efficient  
13          transaction, but the Underwriters’ desire to maximize profits for  
14          themselves and investors were not always in line with our goals as  
15          issuer.

16          In fact, underwriting agreements clearly state that the Underwriters  
17          do not have a fiduciary responsibility in these types of transaction.  
18          Witness Brian Maher of Saber delineates this issue extensively in his  
19          testimony.

20          From my work experience, an analogy comes to mind which strongly  
21          resembles the issue at hand. For decades, “Fairness Opinions” have  
22          played an integral part in merger and acquisition (M&A) transactions.

23          A Fairness Opinion is a letter summarizing an analysis prepared by

1 an investment bank or an independent financial third party, which  
2 indicates whether certain financial elements in a transaction, such as  
3 price, are fair to a specific constituent. These opinions often are  
4 issued to assist the Board of Directors in assessing the  
5 appropriateness of an M&A transaction so they can fulfill their  
6 fiduciary duty to shareholders. The Fairness Opinion does not  
7 include a recommendation on whether the Board should approve the  
8 transaction. Rather, it helps the Board build a record that it has  
9 satisfied its fiduciary duty of care in reviewing the transaction.

10 However, these Fairness Opinions are not without controversy. A  
11 principal objection is that the Fairness Opinion often is provided by  
12 the same party that is advising the buyer (or target) for a fee that is  
13 contingent on the successful completion of the deal. This represents  
14 a clear conflict of interest and a potential lack of objectivity.

15 In a typical M&A transaction, both the buyer and target will each  
16 arrange for the delivery of their own separate Fairness Opinions. This  
17 does not necessarily solve the conflict of interest conundrum. These  
18 Fairness Opinions have come under greater scrutiny and litigation in  
19 recent years as almost half of very large M&A transactions have  
20 been challenged.

21 While at Con Edison of New York, I was intimately involved in a  
22 potential acquisition of a neighboring utility. Con Ed, as buyer, and  
23 the target utility obtained Fairness Opinions from our respective

1 investment bankers and announced the transaction. Con Ed then  
2 hired, albeit a little late, an independent financial adviser to evaluate  
3 certain risks relating to the competitive energy marketplace. The  
4 advisor identified some significant risks in the target company's  
5 energy portfolio which had not been delineated in the Fairness  
6 Opinions and which Con Ed was not willing to accept. As a result,  
7 the transaction was cancelled, which later resulted in years of  
8 litigation.

9 The independent financial advisor "saved the day," by recognizing  
10 risks that the conflicted investment bankers did not.

11 That is why it is important for stakeholders, like ratepayers in this  
12 transaction, to have an independent financial advisor whose opinions  
13 and analyses are based on experience and knowledge of the  
14 intricacies of the transaction and market.

15 **Q. IF INVESTORS ARE MOST FAMILIAR WITH TRADITIONAL**  
16 **UTILITY BONDS AND ARE LIKELY TO COMPARE THESE**  
17 **STORM RECOVERY BONDS TO THOSE SECURITIES, WITH**  
18 **RESPECT TO LEGAL CHARACTERISTICS, HOW DO STORM**  
19 **RECOVERY RATEPAYER-BACKED BONDS COMPARE TO**  
20 **TRADITIONAL UTILITY BONDS?**

21 A. The securitized storm recovery utility bonds themselves are simple  
22 and straightforward. As most commonly structured, they are carried  
23 as obligations of the consolidated entity for accounting and tax

1 purposes, much like conventional corporate securities. However, the  
2 structure of the SPE issuer and the administration of the collateral  
3 supporting Ratepayer-Backed Bonds require extensive  
4 documentation. For example, Ratepayer-Backed Bonds require a  
5 Sale Agreement, Servicing Agreement, Administration Agreement,  
6 special tax, bankruptcy, and other legal opinions, and must meet  
7 other requirements of the rating agencies for a “AAA” rating.

8 **Q. GIVEN THAT THERE HAS BEEN ABOUT \$50 BILLION OF**  
9 **RATEPAYER-BACKED BONDS SOLD OVER THE LAST 20**  
10 **YEARS, AT ANY TIME, ISN'T THERE AN EASILY IDENTIFIABLE**  
11 **RATE FOR ALL RATEPAYER-BACKED BONDS WITH THE**  
12 **SAME SCHEDULED MATURITY?**

13 A. No. First of all, less than \$5 billion of the \$50 billion issued, are still  
14 outstanding. Second, and perhaps more important, the Ratepayer-  
15 Backed Bonds have been re-sold infrequently. This means that in  
16 rapidly changing and dynamic markets there is not a focus on these  
17 bonds. Moreover, since the credit crisis of 2008-09, there has been  
18 a tremendous amount of turnover among investors, Underwriters,  
19 and market makers.

20 Though many discussions with Underwriters defer pricing decisions  
21 to “the market,” there is no simple way to assess the interest rate for  
22 the bonds of any issuer, particularly an infrequent issuer that is  
23 forced to sell into the market. Some assert that there is a known rate

1 (spread/yield) for new issue bonds based on the “market” where  
2 Ratepayer-Backed Bonds are currently traded in the secondary  
3 market. The problems with this argument are manifold:

- 4 1. There is no active daily trading of Ratepayer-Backed Bonds.
- 5 2. Secondary market prices and amounts are often small odd  
6 lots that carry widely differing dollar prices, all of which affect  
7 direct comparisons to par priced issues.
- 8 3. New issuances of Ratepayer-Backed Bonds have been  
9 sporadic and infrequent, and marketing efforts have varied  
10 widely. Thus, there is not a constant flow of new issue pricing  
11 information to establish any consistent benchmark.

12 An efficient market matches a willing buyer and willing seller, each  
13 having access to all information that is material to the investment  
14 decision. So, when we get to the basics, it is a matter of negotiation,  
15 marketing, and selling even in a competitive bidding situation. The  
16 price of your house is not solely a function of the price of other  
17 houses for sale. No two houses are identical. It is a function of a  
18 range of factors affecting perception concerning quality, replacement  
19 value and other factors, including the needs of specific buyers. The  
20 same principles apply to the marketing of ratepayer-backed bonds.

1                                   **GETTING THE MOST VALUE FROM UNDERWRITERS AND**  
2                                   **INVESTORS FROM A TOP CREDIT RATING**

3           **Q.     AREN'T ALL SECURITIES THAT HAVE THE SAME MATURITY**  
4                                   **AND IDENTICAL "AAA" RATINGS PRICE THE SAME SO THERE**  
5                                   **IS VERY LITTLE NEED TO PROTECT RATEPAYER INTERESTS?**

6           A.    No. As described in Witness Sutherland's testimony, there are wide  
7                                   discrepancies in pricing between and among securities of the same  
8                                   rating, even within the Ratepayer-Backed Bond market segment.  
9                                   These discrepancies exist in both the market for new issuances and  
10                                  in the secondary market for prior issuances, and they are particularly  
11                                  acute for first-time issuers of Ratepayer-Backed Bonds. This is called  
12                                  "relative value" of the security.

13           **Q.     WOULD APPEALING TO A CERTAIN TYPE OF AN INVESTOR**  
14                                   **SEGMENT AFFECT THE COST OF STORM RECOVERY BONDS**  
15                                   **AND THEREFORE RATEPAYER COSTS?**

16           A.    Yes. As described in the testimony of Witness Maher, appealing to  
17                                   the appropriate investor segment creates the baseline by which  
18                                   investors value the security and determine the interest rate they will  
19                                   accept to hold the Ratepayer-Backed Bonds.

20                                  For example, an investor who wishes to make a quick profit in trading  
21                                  the security (also known as a "Flipper") might be on the prowl for  
22                                  bonds that are likely to be over-subscribed in the initial offering, with  
23                                  a view to immediately re-selling the bonds at a higher price to other



1 investors who placed unfilled orders at the initial offering price.  
2 Targeting investors who are very worried about maintaining their  
3 principal for the long-term and who do not expect to sell the bonds in  
4 the near future (the “Buy and Hold” investor) may accept a lower  
5 interest rate because those investors are more concerned about  
6 long-term risk than a quick profit. Foreign investors who want safety  
7 in U.S. dollars (e.g., investors from China) may also be willing to  
8 accept lower yields than U.S. domestic hedge fund managers who  
9 have high yielding targets for their investment portfolio to keep  
10 attracting capital inflows to their funds.

11 Furthermore, appealing to the broadest possible base of investors,  
12 rather than targeting a small group of large accounts, will create  
13 greater competition. Large investor accounts often believe they have  
14 “market power” and therefore can demand higher yields for quick  
15 execution with their capital. Although Underwriters are sometimes  
16 willing to oblige them, competition with other Underwriters and  
17 investors can drive the market to lower costs.

18 **Q. HOW SHOULD RATEPAYER-BACKED BONDS BE PRICED IF**  
19 **THE MARKETS WERE EFFICIENT AND THE RELATIVE VALUE**  
20 **OF THE BONDS FULLY UNDERSTOOD?**

21 A. If the Ratepayer-Backed Bonds are properly structured as corporate  
22 securities and not asset-backed securities, as described in Witness  
23 Sutherland’s testimony about the MP Funding, PE Funding, and

1 Duke Energy Florida Project Finance bonds, then they will appeal to  
2 the large and diverse corporate bond market and not the more limited  
3 asset-backed securities market. For example, the Barclays (now  
4 Bloomberg-Barclays) bond indexing service for the first time included  
5 the 2016 DEF ratepayer-backed bonds in their Corporate Utility Bond  
6 Index (see HS EXHIBIT A, Barclays Technical Note: Classification of  
7 Duke Energy Florida Project Finance, LLC Bonds). Many investors  
8 use this index to judge the performance of their portfolios, so this  
9 vastly expands the market since many of these investors must buy  
10 the index. The financial press noted this important development in  
11 June 2016. (See Schoenblum Exhibit 2, Asset Securitization Report,  
12 Duke Utility Fee Securitization Sets Important Precedent, June 21,  
13 2016.) The bonds achieved record low interest rates and credit  
14 spreads for long-term Ratepayer-Backed Bonds.

15 In an efficient market where all potential investors are properly  
16 educated on the relative value of Ratepayer-Backed Bonds versus  
17 market comparables, Ratepayer-Backed Bonds would likely be  
18 priced like U.S. agency securities or other top corporate AAA rate  
19 bonds, like Johnson & Johnson, as the 2016 DEF Ratepayer-Backed  
20 Bonds did. We would expect storm recovery bonds issued forth  
21 Companies to achieve similar results if properly structured and  
22 marketed.

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**SUMMARY OF A BEST PRACTICES APPROACH**

**Q. PLEASE SUMMARIZE THE SPECIFIC STEPS OF THE BEST PRACTICES APPROACH FOR THE COMMISSION IN THE STORM RECOVERY BOND ISSUANCE PROCESS.**

A. The Commission should:

1. Participate in the selection of underwriters, legal counsel, and other transaction participants and in defining the responsibilities of each to the extent that each is to be paid directly or indirectly from storm recovery bond proceeds or from the storm recovery charge collections. To assist it in implementing its authority, the Commission, or its designee, should act by and through its staff, the Public Staff, and their experts to serve as joint-decision maker with the applicant utilities in all matters related to the structuring, marketing and pricing of the proposed storm recovery bonds. The experts the Commission relies upon should have a duty solely to protect ratepayers and be free of any conflicts of interests with the utility, underwriters or investors.<sup>1</sup>

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<sup>1</sup> See Wisconsin PSC's 2004 Financing Order issued to Wisconsin Electric Power Company (Docket 6630-ET-100), Ordering Paragraph 7 ("The Commission shall oversee all negotiations regarding the structuring, marketing, and pricing of the environmental trust bonds and, without limitation, the selection of underwriter(s), counsel, trustee(s) and other parties necessary to the transaction and to review and approve the terms of all transaction documents.")

- 1           2.     Reduce risks borne by ratepayers through careful review and  
2                                 negotiation of all transaction documents and contracts that  
3                                 could affect future ratepayer costs.
- 4           3.     Ensure that all statutory limits which benefit ratepayers are  
5                                 strictly enforced.
- 6           4.     Establish procedures to ensure that all savings are allocated  
7                                 or transferred to ratepayers.<sup>2</sup>
- 8           5.     Require that the storm recovery bonds be offered to the  
9                                 broadest market possible to expand the market to garner

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<sup>2</sup> See the California PUC's 2004 Financing Order issued to PG&E (Decision 04-11-015 November 19, 2004), pages 40 and 41 ("To the extent PG&E's incremental costs to provide this service are less than the servicing fee revenue from the Bond Trustee, PG&E will return that excess revenue to consumers through the ERBBA."); New Jersey BPU's 2005 Financing Order issued to PSE&G (BPU Docket No. EF03070532), Ordering Paragraph 22 ("However, if the Servicing Fee is greater than the actual incremental costs to service the BGS Transition Property, other rates of the Petitioner shall be adjusted to reflect the difference between actual servicing costs and the Servicing Fee."); Montana PSC's 1998 Financing Order issued to Montana Power (Docket No. D97.11.219; Order No. 6035a), pages 6 and 7 ("The full amount of the market-based servicing fee will be included in the FTA charges. However, as long as Applicant is servicer, Applicant proposes a ratemaking mechanism that will provide a credit to ratepayers equal in value to any amounts it receives as compensation, since these servicing costs will generally be included in the Applicant's overall cost of service."); California PUC's 1997 and 1998 Financing Orders issued to PG&E (Decision 97-09-055 September 3, 1997), SCE (Decision 97-09-056 September 3, 1997), SDG&E (Decision 97-09-057 September 3, 1997) and Sierra Pacific (Decision 98-10-021 June 24, 1998), page 6 ("The full amount of the market-based servicing fee will be included in the FTA charges. However, as long as PG&E is servicer, PG&E proposes a ratemaking mechanism which will provide a credit, after the rate-freeze period, to residential and small commercial ratepayers in PG&E's Rate Reduction Bonds Memorandum Account equal in value to any amounts it receives as compensation, excepting only amounts needed to cover incremental, out-of-pocket costs and expenses incurred by PG&E to service the RRBs. These types of expenses would include required audits related to PG&E's role as servicer, and legal and accounting fees related to the servicing obligation. Thus, the only net ratemaking impact will be such incremental expenses.").

- 1 lower interest rates for the benefit of ratepayers through  
2 increased competition.<sup>3</sup>
- 3 6. Require transparency in the distribution, in the initial pricing  
4 and in the secondary market for the storm recovery bonds to  
5 support the integrity of the process.
- 6 7. Direct the Commission's staff and the Public Staff and its  
7 independent financial advisor to take part fully and in advance  
8 in all aspects of structuring, marketing, and pricing the storm  
9 recovery bonds, and direct the financial advisor to disapprove  
10 any decision that would not result in the lowest all-in cost of  
11 funds and the lowest storm recovery charges to ratepayers.<sup>4</sup>  
12 This should include:

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<sup>3</sup> In support of this best practice, it will be useful for the financing order to include a variety of findings, including (a) each SPE is responsible to the Commission in connection with its issuance of storm-recovery bonds; (b) storm-recovery property is not a receivable; (c) the State Pledge and the automatic true-up adjustment mechanism constitute a State of Florida guarantee of regulatory action to ensure payment of principal and interest on the storm-recovery bonds (see e.g., Wisconsin PSC 2004 Financing Order issued to Wisconsin Electric (Docket 6630-ET-100), Ordering Paragraph 1: "The approval of this Financing Order, including the true-up provisions, by the Commission constitutes a guarantee of state regulatory action to ensure repayment of the environmental trust bonds and associated costs."; California PUC 2004 Financing Order issued to PG&E (Decision 04-11-015 November 19, 2004), Ordering Paragraph 40: "All true-up adjustments to the DRC shall guarantee the billing of DRC charges necessary to generate the collection of amounts sufficient to make timely provision for all scheduled (or legally due) payments . . ."); and (d) if all private consumers of electricity in FPL's service area cease to consume electricity and/or fail to pay storm-recovery charges, the automatic true-up adjustment mechanism will cause state and local governments in FPL's service area to be payors of last resort.

<sup>4</sup> See Ordering Paragraph 26 of the Texas PUC's 2005 Financing Order issued to CenterPoint PUC Docket No. 30485); Ordering Paragraph 21 of the Texas PUC's 2002 Financing Order issued to Central Power & Light (Docket 21528); Ordering Paragraph 21 of the Texas PUC's 2002 Financing Order issued to TXU Electric (Docket No. 21528); Ordering Paragraph 21 of the Texas PUC's 2002 Financing Order issued to Reliant Energy (Docket No. 21665); Ordering Paragraph 17 of the New Jersey BPU's 2005 Financing

- 1 a. Reviewing, analyzing, and proposing revisions to all  
2 documentation to better protect ratepayers, including  
3 specific certifications, representations, indemnities,  
4 and warranties, therefore protecting against higher  
5 (and hidden) post-transaction ratepayer costs;
- 6 b. Evaluating the performance of underwriters of prior  
7 Ratepayer-Backed Bonds;<sup>5</sup> include in any offering or  
8 bidding syndicate one or more underwriters without  
9 prior relationships with the Companies or their affiliates  
10 (prior relationships can entail conflicts of interest); tie  
11 any negotiated Underwriter compensation to  
12 performance—actual storm recovery bond sales at  
13 lower cost to ratepayers—to create competition within  
14 the underwriting syndicate and promote lowest cost;<sup>6</sup>

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Order issued to PSE&G (BPU Docket No. EF03070532); Ordering Paragraph 7 of the Wisconsin PSC's 2004 Financing Order issued to Wisconsin Electric Power Company (Docket 6630-ET-100).

<sup>5</sup> See Ordering Paragraph 26 of the Texas PUC's 2005 Financing Order issued to CenterPoint PUC Docket No. 30485); Ordering Paragraph 21 of the Texas PUC's 2002 Financing Order issued to Central Power & Light; Ordering Paragraph 21 of the Texas PUC's 2002 Financing Order issued to TXU Electric (Docket No. 21528); Ordering Paragraph 21 of the Texas PUC's 2002 Financing Order issued to Reliant Energy (Docket No. 21665); Ordering Paragraph 17 of the New Jersey BPU's 2005 Financing Order issued to PSE&G (BPU Docket No. EF03070532); Ordering Paragraph 7 of the Wisconsin PSC's 2004 Financing Order issued to Wisconsin Electric (Docket 6630-ET-100).

<sup>6</sup> See Texas PUC's 2005 Financing Order issued to CenterPoint (PUC Docket No. 30485), Finding of Fact 110: "The Commission's financial advisor or designated representative shall require a certificate from the bookrunning underwriter(s) confirming that the structuring, marketing, and pricing of the transition bonds resulted in the lowest transition bond charges consistent with market conditions and the terms of this financing order." See also Wisconsin PSC's 2004 Financing Order issued to Wisconsin Electric Power Company (Docket 6630-ET-100), Ordering Paragraph 37: "Following determination of the final terms

- 1 c. If a negotiated underwriting process is selected,  
2 underwriters need to develop a written marketing plan  
3 well in advance of actually entering the market. The  
4 written plan should implement robust marketing efforts  
5 tailored to the unique strengths of the storm recovery  
6 bonds, emphasizing the need to broaden distribution  
7 and to attract non-traditional investors, and rejecting  
8 Underwriters' plans that focus solely on selling storm  
9 recovery bonds to previous ratepayer-backed bond  
10 investors;
- 11 d. Continually analyze market developments and  
12 transactions to adopt successful techniques and utilize  
13 them in new issuance(s); and
- 14 e. "Trust but Verify": require Underwriters to document  
15 and support their marketing efforts and pricing  
16 recommendations to ensure their full attention and  
17 focus on accuracy and due diligence, thereby fostering  
18 aggressive pricing.
- 19 8. Require fully accountable certifications from the bookrunning  
20 underwriter(s), the Companies and the Public Staff's financial  
21 advisor as to actions taken to achieve the lowest cost of funds

1 and the lowest storm recovery charges under market  
2 conditions at the time of pricing.

3 9. Provide that the Commission has authority to enforce the  
4 provisions of the Financing Order, the Servicing Agreement,  
5 the Sale Agreement, the Indenture, and other transaction  
6 documents for the benefit of the ratepayers.<sup>7</sup>

7 **Q. DOES THAT CONCLUDE YOUR TESTIMONY?**

8 A. Yes.

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<sup>7</sup> See e.g., Wisconsin PSC's 2004 Financing Order issued to Wisconsin Electric Power Company (Docket 6630-ET-100), Ordering Paragraph 17 ("The Commission, acting on its own behalf or through the Attorney General, may enforce this Financing Order and related transaction documents, including those contemplated by the Affiliated Interest Final Decision, for the benefit of Wisconsin ratepayers to the extent permitted by law including, the enforcement of any ratepayer indemnification provisions in connection with specified items in the servicing agreement.")







## Technical Note

# Classification of Duke Energy Florida Project Finance, LLC Series A Bonds

Following a formal *consultation* period, the Barclays index group plans to classify index-eligible Duke Energy Florida Project Finance Series A bonds (Ticker: DUK; issued on June 16, 2016) as Corporate > Utility issues.

For any questions, please contact your regional index group or email [index\\_feedback@barclays.com](mailto:index_feedback@barclays.com).

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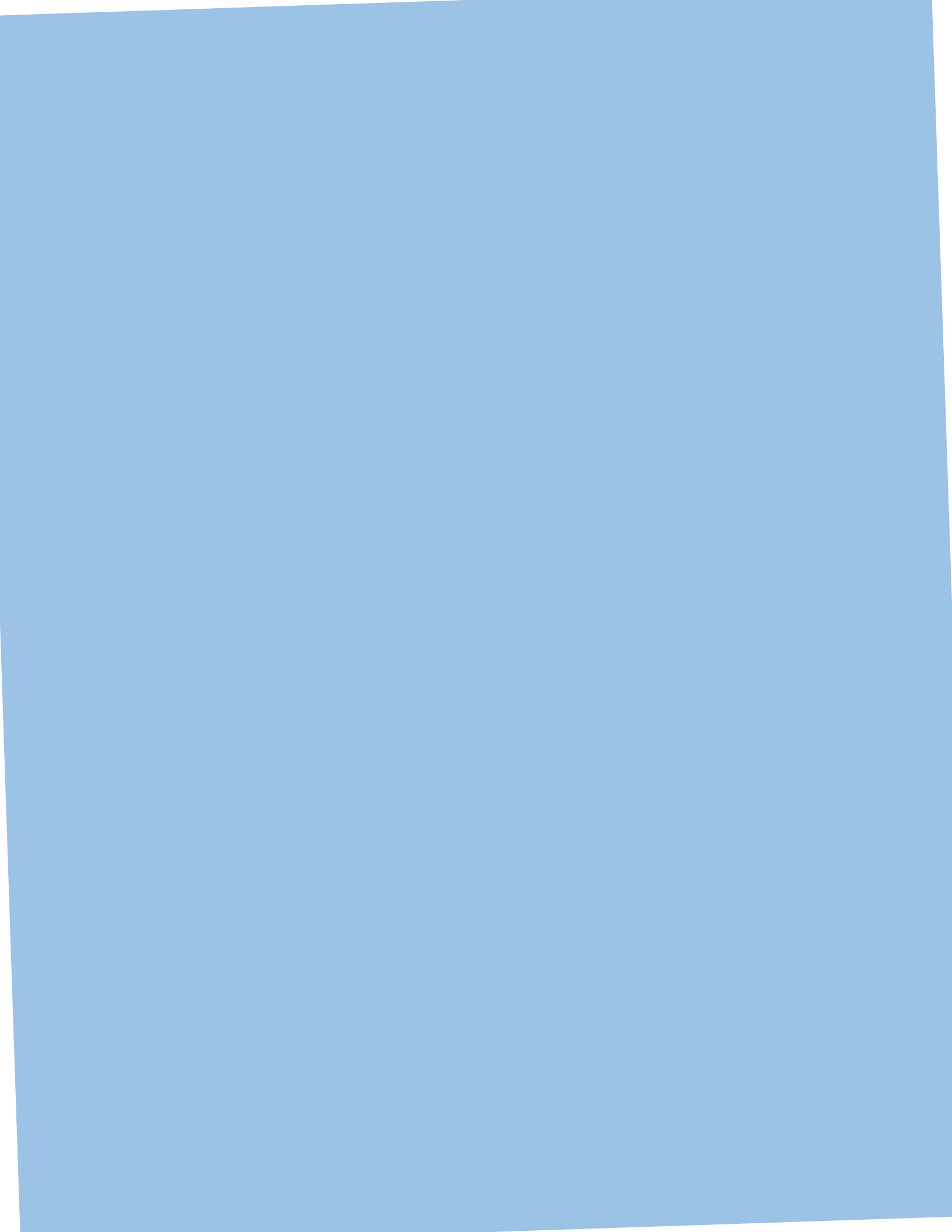
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## Asset Securitization Report

June 21, 2016

# Duke's Utility Fee Securitization Sets Important Precedent

By Allison Bisbey

Duke Energy Florida marketed its \$1.3 billion securitization of utility fees as a corporate bond, and the strategy appears to have paid off. The deal was priced last week at interest rates in line with those of some of the highest rated U.S. companies and government agencies.

DEF's bonds are tied to a special charge on the utility's electric delivery and transmission services that is associated with the retirement of the Crystal River Unit 3 nuclear power plant. The bonds are also backed by a guarantee of the state's utility regulator to adjust the charge every six months to whatever level is necessary to pay the bonds on time.

The securities have unusually long durations for this sector; over \$500 million had maturities from 15 to almost 19 years. By comparison, most other deals in the utility sector have original terms under 10 years. The tranche with the longest duration pays a spread over Treasuries similar to those of triple-A rated bonds issued by Johnson & Johnson and the Tennessee Valley Authority.

The all-in duration adjusted cost of the \$1.297 billion offering was 2.72%, an all-time low for a bond offering with such long maturities, according to Andrew Maurey, director of the division of accounting and finance at the Florida Public Service Commission.

Even so, DEF may have left some money on the table. That's because it wasn't until Friday, after the deal priced, that Barclays announced it would classify the bonds as corporates for the purposes of its bond indexes – which could attract a broader investment base.

Had this determination been made before the bonds were priced, DEF might have lowered its funding costs even further.

The two-year tranche priced at a spread of 47 basis points over Treasuries, several basis points wide of where similarly rated credit card securitizations from Chase and Citigroup were trading in the secondary market; the five-year tranche priced at Treasuries plus 60 basis points, wide of comparable credit card deals; the 10-year tranche priced at 93 basis points over Treasuries, more than 10 basis points wide of comparable bonds issued by companies like the TVA and Johnson & Johnson.

RBC Capital Markets and Guggenheim Securities served as joint bookrunning managers.

Still, inclusion in Barclays' corporate index could set a precedent for future utility deals structured in a similar manner.

The bonds will be issued by DEF's wholly owned, but bankruptcy remote, subsidiary, Duke Energy Florida Project Finance. The offering prospectus was filed with the Securities and Exchange Commission on a form SF-1, which is designated for asset-backed. Yet this filing describes the bonds as "a type of ratepayer obligation charge bond." It goes on to state that the bonds are "corporate securities," and "are not asset-backed securities as defined by the SEC governing regulations."

Notably, there is no tranching for credit risk; all five tranches of securities issued by DEF Project Finance are rated triple-A by three credit rating agencies: Moody's Investors Service, Standard & Poor's, and Fitch Ratings. That means neither investors nor rating agencies need to analyze how cash flows might be diverted to different classes of bonds under different scenarios. The only difference between the classes is the maturity dates.

The bonds will be included on DEF's consolidated balance sheet and treated as debt of DEF for U.S. corporate income tax purposes.

(Unlike corporate bonds, most asset-backed are subject to a requirement that sponsors retain at least 5% of the credit risk of the collateral. However DEF did not need to argue that its deal is a corporate bond in order to avoid this requirement. Utility fee securitizations already benefit from a carve-out from risk retention rules.)

DEF may have left some money on the table in another respect: it did not market the bonds to European investors, traditionally important buyers of utility fee securitizations.

Maurey said that the Commission did consider the European market, but concluded that the bonds could be priced and sold cost effectively in the US without having to cross the pond.

"Given how the markets reacted to Brexit news at the time of pricing, perhaps a European effort would have produced even better results," he said. "We had a great outcome with this issuance. But if the need to issue these type of bonds arises in the future, expanding the marketing beyond the US should receive stronger consideration."

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