

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)
Carolinas, LLC and Duke Energy)
Progress, LLC Issuance of Storm)
Recovery Financing Orders)
)
)

DIRECT TESTIMONY OF
JOSEPH S. FICHERA CHIEF
EXECUTIVE OFFICER OF
SABER PARTNERS, LLC

BEFORE THE NORTH CAROLINA UTILITIES COMMISSION

Docket No. E-2, Sub 1262

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Direct Testimony of

Joseph S. Fichera

Senior Managing Director and Chief Executive Officer

Saber Partners, LLC

December 21, 2020

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INTRODUCTION

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

2 A. Joseph S. Fichera, Saber Partners, LLC, 260 Madison, Suite 8019
3 New York, New York 10016.

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

6 A. I am a member of Saber Partners, LLC and serve as its Chief
7 Executive Officer.

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

10 A. I manage the organization and execute assignments for clients by
11 providing confidential, independent, senior-level analysis, advice, and
12 execution for chief executive officers, regulators, elected officials, chief
13 financial officers, treasurers and others. Since 2001, our firm has focused
14 on achieving lowest cost for ratepayers in Ratepayer-Back Bond
15 transactions.

16 **Q. WHAT IS YOUR EDUCATIONAL BACKGROUND AND**
17 **PROFESSIONAL EXPERIENCE?**

18 A. I have a Bachelor's degree in Public Affairs from Princeton
19 University's Woodrow Wilson School of Public and International Affairs. I
20 also have a Master's degree in Business Administration from Yale

1 University's School of Management. In 1995-1996, I was an executive
2 fellow in residence at the Woodrow Wilson School of Public and
3 International Affairs at Princeton. In 2018 the National Regulatory Research
4 Institute (NRRI) part of the National Association of Regulatory Utility
5 Commissions (NARUC) selected me to be one their first ever "National
6 Fellows" for 2018-2019. In connection with that, I wrote an article for the
7 NRRI on securitization transactions for investor-owned electric utilities/
8 Ratepayer-Backed Bonds that was published in January 2019. The
9 economic burden of repaying these bonds falls squarely on the ratepayers
10 in the service territory; hence they are aptly referred to as "Ratepayer-
11 Backed" bonds (Ratepayer-Backed Bonds).

12 Since 1982, I have worked in the fields of finance and investment banking.
13 I began as an Associate in the Public Finance Department of Dean Witter
14 Reynolds (now a part of Morgan Stanley) from 1982-1984. I then served as
15 Vice President in Corporate Finance at Smith Barney Harris Upham (now a
16 part of Citigroup) from 1984-1989. I became a Managing Director, Principal
17 in Corporate Finance and Capital Markets at Bear Stearns and Co, Inc. from
18 1989-1995. Following my fellowship at Princeton in 1996, I served as
19 Managing Director and Group Head of Prudential Securities Business
20 Origination and Product Development Unit from 1997-2000. With several
21 colleagues from the utility, law, and banking industries, I formed Saber
22 Partners, LLC in 2000. I have held a general securities principal license

1 (Series 24) from the U.S. Securities and Exchange Commission (SEC) as
2 well as a general securities representative license (Series 7 and 63).
3 Since forming Saber Partners, I have engaged in many complex
4 assignments in the energy and finance field. I served as a chief financial
5 advisor, along with the Blackstone Group, to the governor of the State of
6 California during 2001. We assisted in developing the Governor's response
7 to the energy crisis beginning in March 2001. I also have served as the
8 chief financial advisor to six state utility commissions or their agents
9 (Florida, Texas, West Virginia, Wisconsin, Vermont, and New Jersey) and
10 the Office of the People's Counsel for the District of Columbia on the use of
11 Ratepayer-Backed Bonds and specifically the structuring, marketing, and
12 pricing of approximately \$9.25 billion in Ratepayer-Backed Bonds. I have
13 also been engaged as an advisor to the SEC and ExxonMobil Corporation,
14 among others. I currently serve on the Board of Advisors of Princeton's
15 Center for Economic Policy Studies. I also served as Chairman of the
16 Princeton Economics Department Advisor Council. In that capacity, I
17 served as an advisor to Federal Reserve Chairman Ben Bernanke when he
18 was the Chairman of the Economics Department of Princeton University in
19 the 1990s. My vitae is attached to this testimony as Fichera Exhibit 1.

1 **Q. DURING YOUR CAREER ON WALL STREET, DID YOU**
2 **PARTICIPATE IN ANY UNDERWRITINGS – THE SALE OF SECURITIES**
3 **TO INVESTORS IN PUBLIC OFFERINGS?**

4 A. Yes. The primary focus of my positions from Associate to Managing
5 Director was first to advise on, structure, and execute on underwritings and
6 private placements of debt and equity issuances. My role evolved to
7 providing strategic advice to corporate treasurers, chief financial officers,
8 and chief executive officers.
9 My responsibilities included advising all these officers and their legal
10 counsel on the structuring, marketing, and pricing of publicly-offered
11 securities. I also led or participated in corporate reorganizations and
12 restructurings. My underwriting experience included direct negotiations
13 with corporations, utilities, and investors over the structuring, marketing and
14 pricing of publicly-offered debt and equity securities. My primary role was
15 as the Bookrunning Underwriter, sole manager or senior manager. I also
16 have experience as a co-managing Underwriter of publicly-offered debt and
17 equity securities.¹

¹ As an Underwriter, I received three “Deal of the Year” awards from industry publications. These are awards for transactions that independent observers who closely follow the profession consider significant and merit the attention of one’s peers. In 1990, for a preferred stock transaction, I received the award from “Institutional Investor” magazine. In 1991, I received this award again for an investor-owned utility debt reorganization in the municipal bond market. In 2003, I was recognized with a similar “Deal of the Year” award from “Asset Securitization Report” for a Ratepayer-Backed Bonds offering. “Deal of the Year” awards generally identify transactions that have unique features, overcame specific market obstacles or set precedents in the financial markets.

1 **Q. HAVE YOU PARTICIPATED IN TRANSACTIONS INVOLVING**
2 **RATEPAYER-BACKED BONDS SIMILAR TO THE STORM RECOVERY**
3 **BONDS PROPOSED BY THE JOINT PETITION?**

4 A. Yes. To-date, I have participated in 13 Ratepayer-Backed Bond
5 transactions for over \$9.25 billion, involving eight different investor-owned
6 electric utilities.

7 **Q. HAVE YOU HAD DIRECT INTERACTIONS WITH INVESTORS,**
8 **UNDERWRITERS AND REGULATORS CONCERNING THE TYPE**
9 **OF SECURITIES THAT ARE THE SUBJECT OF THE JOINT PETITION?**

10 A. Yes.

11 **Q WAS YOUR INTERACTION WITH BOTH UNDERWRITERS AND**
12 **INVESTORS?**

13 A. Yes, with many investors, underwriters, counsel and others in my
14 capacity as the financial advisor on an ongoing basis over the past 20 years.

15 **Q. HOW DID YOU INTERACT WITH INVESTORS? ISN'T THAT**
16 **SOLELY THE JOB OF THE UTILITY AND THE UNDERWRITERS?**

17 A. Ratepayer-Backed-Bond issues are unique because they are a
18 direct borrowing on the credit of all the utility's ratepayers supported by a
19 unique guarantee of the regulator. The special characteristics of the
20 authorizing legislation and the financing order (Financing Order) often raise
21 many questions about the financing order. As the regulator's financial

1 advisor and from the perspective of the regulator and ratepayers, I have
2 explained the commission's important role in writing the terms of the
3 Financing Order. The Financing Order is the basis for the bond financing
4 and implementing the adjustment mechanism known as the true-up
5 mechanism. I have assisted staff and others in discussing the Financing
6 Order, the authorizing legislation, and the support for the financing. This
7 included discussing the benefits of the transaction for the ratepayer and
8 regulator as well as the relative value of this credit mechanism to other
9 mechanisms in the marketplace.

10 **Q. WERE THESE INDIVIDUAL MEETINGS OR GROUP**
11 **PRESENTATIONS?**

12 A. Both. I have spoken directly with individual investors and
13 Underwriters as well as participated in what are known as investor
14 roadshows, both electronically and in person, on each offering of
15 Ratepayer-Backed Bond offerings.

16 I have also conducted various "teach-ins" with Underwriters and their
17 salesforces. There often is a great deal of incorrect information,
18 misinformation and just plain myths about Ratepayer-Backed Bonds.
19 Providing accurate information about the particular Ratepayer-Backed
20 Bonds being offered, as well as the particular Financing Order, to market
21 participants is an important function at Saber Partners.

1 Q. HAVE YOU SPOKEN AT MEETINGS OF THE NATIONAL
2 ASSOCIATION OF REGULATORY COMMISSIONERS (NARUC) OR OF
3 OTHER UTILITY ASSOCIATIONS AND CONSUMER GROUPS, AND
4 INVESTOR FINANCIAL CONFERENCES ON MATTERS RELATED TO
5 THE ISSUES IN THE JOINT PETITION?

6 A. Yes. A core part of my job at Saber Partners has been as a resource
7 to regulatory commissioners and their staffs, consumer groups, investors
8 and others interested in this type of financing. In 2006, 2009 and 2018,
9 NARUC asked me in to present at their meeting on utility securitization
10 issues. In addition, the NARUC Subcommittee on Electricity asked me to
11 present to the Subcommittee alongside Jon McKinney, former Chairman of
12 the West Virginia Public Service Commission (WVPSC), at the May 2019
13 monthly meeting.

14 The Society of Utility Regulatory and Research Financial Analysts (SURFA)
15 asked me to address Ratepayer-Backed Bonds at their annual meeting in
16 April 2019. In addition, they requested that I help organize and participate
17 in a July 2020 webinar on utility securitization/Ratepayer-Backed Bonds as
18 a possible tool to address costs arising from the COVID-19 pandemic.

19 The National Association of State Utility Consumer Advocates (NASUCA)
20 asked me to address their Accounting Committee in July 2020 and to
21 organize a panel and speak at their national annual meeting on November
22 9, 2020 concerning the Ratepayer-Backed Bond financing tool and the

1 issues concerning protecting consumers. NASUCA had previously asked to
2 address their national annual meeting in 2009.
3 The Investor Management Network (IMN) asked me to lead panel
4 discussions on issues related to Ratepayer-Backed Bonds in 2003 and
5 2005 at their conference of 3,000 or more participants known as “ABS East.”
6 I also was asked to lead a panel discussion on pricing transparency – the
7 ability for investors and regulators to see actual trades for prices of
8 securities transactions – in 2007 and 2008. The 2007 panel led to major
9 reforms of the entire securitization market in 2011.

10 **TESTIMONY FROM OTHER SABER PARTNER WITNESSES**

11 **Q. WHO ELSE FROM SABER PARTNERS WILL BE PROVIDING**
12 **TESTIMONY?**

13 A. Testimony concerning the Joint Petition will be submitted by:

14 **Rebecca Klein**, former Chair of the Public Utility Commission of Texas
15 (PUCT) and a member of the Saber Partners Advisory Board since 2006;

16 **Hyman Schoenblum**, former Treasurer and a top Financial Officer during
17 a 30-year career at Consolidated Edison Company of New York and a
18 Senior Advisor to Saber Partners;

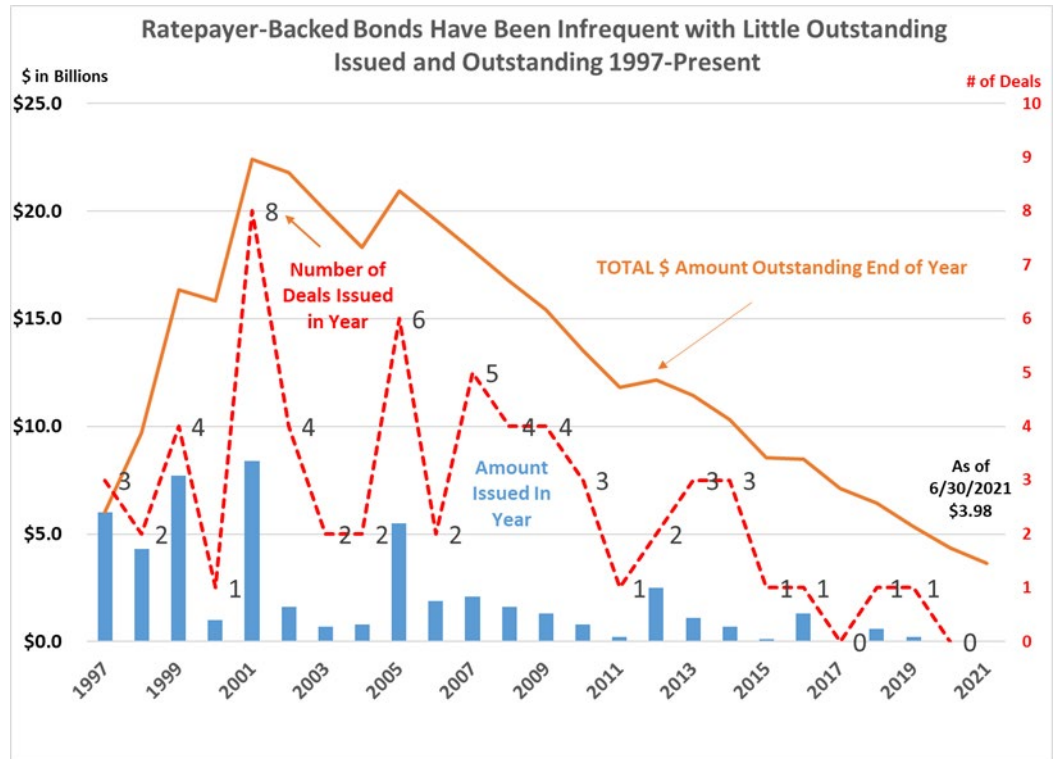
19 **Barry Abramson**, former utility equity analyst and investment advisor and
20 a Senior Advisor to Saber Partners;

1 **Brian A. Maher**, former Assistant Treasurer and 30-year veteran of Exxon
2 Mobil Corporation for external finance and a Senior Advisor to Saber
3 Partners;
4 **Paul Sutherland**, former Assistant Treasurer of Florida Power and Light
5 Company and a Senior Advisor to Saber Partners;
6 **Steven Heller**, President of Analytical Aid who has been an independent
7 modeler of Ratepayer-Backed Bonds and is a consultant to Saber Partners
8 for the purpose of evaluating certain aspects of the Joint Petition; and
9 **William B. Moore**, whose career began as a financial assistant in the
10 treasury department of Kansas Gas & Electric and rose to Chief Financial
11 Officer and then Chief Executive Officer of Westar Energy. He was one of
12 the founding partners of Saber Partners in 2000 before returning to Westar
13 to become President and then CEO with the financial function reporting to
14 him.
15 Because of the technical nature of the issues that are generally not
16 discussed in regulatory proceedings, I am attaching a Glossary of terms as
17 Fichera Exhibit 6, for reference in my testimony and the testimony of other
18 Public Staff witnesses. Except as otherwise defined in my testimony,
19 capitalized terms have the meanings assigned to them in the Glossary.

1 HISTORICAL ISSUANCES OF RATEPAYER-BACKED BONDS
 2 CREATE CHALLENGES

3 Q. BECAUSE THIS IS THE FIRST TIME THE COMMISSION IS
 4 ADDRESSING THESE ISSUES, WHAT SHOULD THEY KNOW ABOUT
 5 THE MARKET FOR RATEPAYER-BACKED BONDS

6 Fichera Figure 1



7

8 There are critical marketing issues to consider when establishing North
 9 Carolina’s Storm Recovery Bond program. It is true that Ratepayer-Backed
 10 Bonds have been around for about 20 years, and as the Companies’
 11 witness Atkins has noted, approximately \$50 billion have been issued in 65
 12 different transactions for investor-owned utilities. However, these bond
 13 issuances have been infrequent, and there are very few bonds remaining

1 outstanding in investor hands when the Companies expect to come to
2 market. The chart above shows the amount issued and outstanding over
3 this 23 year timeframe. This is small when compared with the amount of
4 corporate, utility, and structured finance debt in the market. As a result, a
5 very large part of the market is not familiar with the financing mechanism.
6 The good news is that while Ratepayer-Backed Bonds are relatively small
7 and infrequent, they are the only asset sector that has never experienced a
8 downgrade nor even been on a watchlist for a downgrade by any rating
9 agency.

10 **THREE PHASES OF THE CURRENT RATEPAYER-BACKED BOND**
11 **PROCESS**

12 **Q. ARE THERE ANY DISTINCT PHASES OF ISSUING RATEPAYER-**
13 **BACKED BONDS OF WHICH THE COMMISSION SHOULD BE AWARE?**

14 Following the enactment of enabling legislation, there are three distinct
15 phases for a Ratepayer-Backed Bond sale that the Commission should
16 consider and in which it should be actively engaged.

17

Fichera Figure 2



1
**Petition for
Financing
Order; Write
Detailed
Financing
Order**



2
**Implementation
of the Financing
Order**



3
**Price Bonds
Through Sale to
Investors**

18

1 **Phase One: The Petition for a Financing Order and Writing of the**
2 **Detailed Financing Order.**

3 The Financing Order should be carefully written because it is the basis for
4 the credit associated with the bonds. As the Companies' witnesses Heath
5 and Atkins correctly point out, the precise bond structure, interest rates and
6 other costs cannot be known with certainty at the time the Financing Order
7 is issued. For this reason, the Companies have requested "flexibility"
8 following the issuance of the Financing Order to determine the final
9 structure including the interest rate during the subsequent two phases of
10 the process.

11 **Phase Two: Implementation of the Financing Order.**

12 This is the time between the issuance of the Financing Order and the
13 issuance of the bonds at which time the Financing Order becomes final and
14 irrevocable. This phase involves multiple other parties, including nationally
15 recognized bond rating agencies, to consider the structure of the bonds,
16 their maturity and ability to pay principal and interest. It also involves
17 regulatory, tax, bankruptcy, state and federal law counsel. This phase also
18 includes material decisions regarding the method of sale.

Phase 2 Activities Affecting Ratepayers Include:

- Rating agency discussions, financial modeling stress testing, negotiations
- Documentation of transaction components and legal opinions
- Offering materials including prospectus
- Securities and Exchange Commission filings and discussions
- Selection of offering method – competitive bid or negotiated transaction
- Selection of underwriters
- Requesting, analyzing and oversight of marketing plan and plan of distribution
- Teach-ins for underwriters; investor presentations

1
2 During this second phase, there is extensive modeling of cashflows that will
3 support the bond based on the examination of the utility’s historical
4 forecasts and collections as well as its projections over the next 20 years.
5 This is done to achieve a top credit rating on the bonds from nationally
6 recognized rating agencies like S&P and Moody’s for the possibility of
7 achieving the lowest interest rates from investors.
8 Offering documents are developed and submitted to the Securities and
9 Exchange Commission.
10 The method of sale is decided (competitive bid or negotiated transaction)
11 and a marketing plan is developed.
12 **Phase Three: Pricing the Bonds and Sale to Investors.**
13 Depending on the method of sale chosen, this is the process that concludes
14 the marketing process and establishes the final interest rate in relation to
15 the interest rates on benchmark securities used for comparison for a chosen

1 maturity and principal repayment schedule. Witness Sutherland describes
2 this process in detail in his testimony. This is a dynamic process.

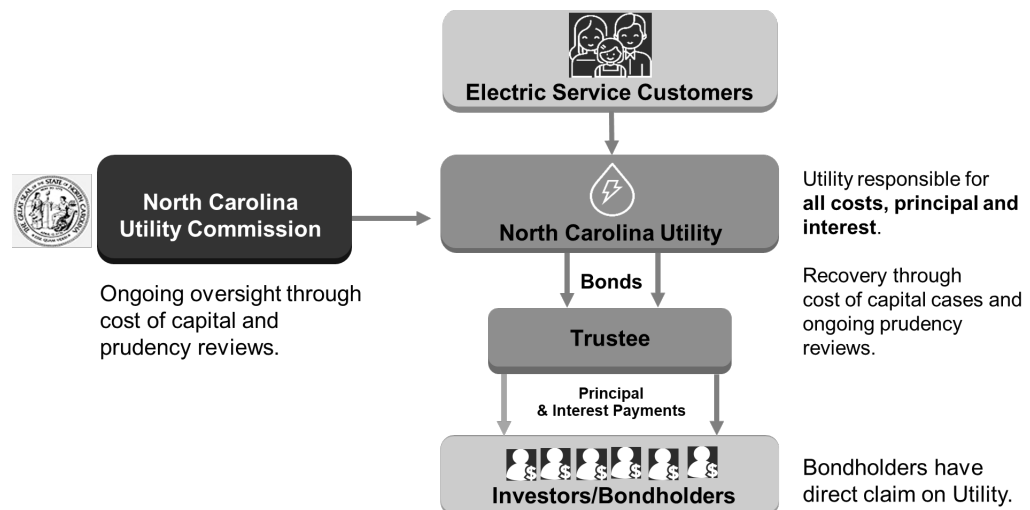
3 **COMPARISON BETWEEN TRADITIONAL UTILITY BONDS AND**
4 **RATEPAYER-BACKED BONDS**

5 **Q. HOW ARE TRADITIONAL UTILITY BONDS STRUCTURED?**

6 Traditional utility bonds are simple and straightforward. The structure,
7 marketing, and pricing are streamlined because the utility is a frequent
8 issuer, i.e., often in the market with a great deal of information readily
9 available to investors. Offering documents often have been prepared in
10 advance and are on file with the Securities and Exchange Commission.

11 As can be seen by the chart below, the structure of a traditional utility bond
12 is direct debt of the utility with the commission retaining all regulatory
13 authority over the utility and all customer rates.

14 *Fichera Figure 4*



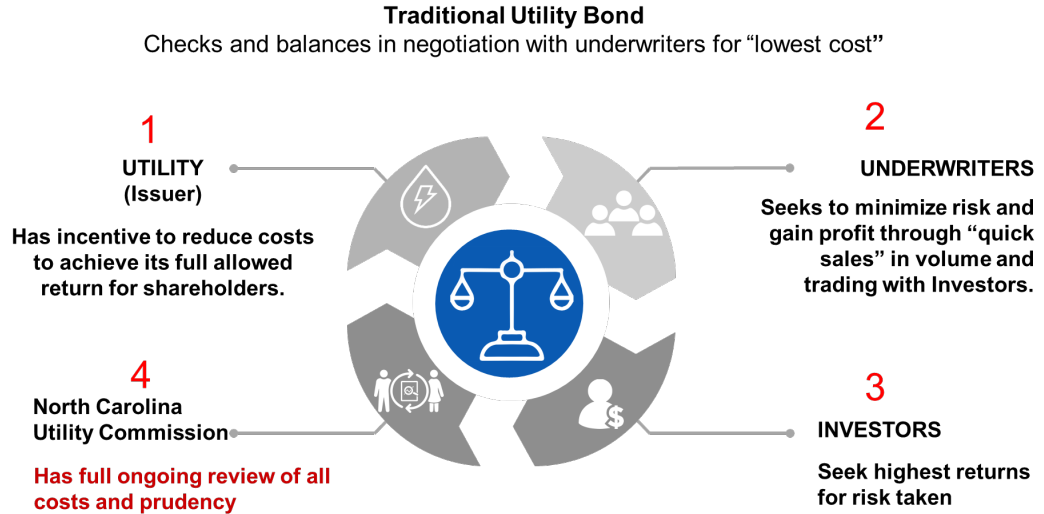
15
16 Traditional bonds are direct debt/obligations of the utility. Bondholders only
17 have a claim on the utility and its assets such as its plant and equipment.

1 In fact, the utility has different levels of security for its debt, like first
2 mortgage bonds that are secured, and other bond issues that are not
3 secured by any claim on property. There is no direct claim on the ratepayers
4 or any specific component of customer rates.

5 From the perspective of the bondholder, the revenue requirements from
6 customer rates to pay principal and interest on traditional utility bonds are
7 not certain. The utility only gets revenues from customer rates approved by
8 the commission through cost of capital proceedings. Those revenues go to
9 all utility costs, including costs of operations, maintenance, taxes, and
10 returns for shareholders, not just principal and interest on bonds.

11 **Q. ARE THERE CHECKS AND BALANCES IN THE STRUCTURING,**
12 **MARKETING AND PRICING OF TRADITIONAL UTILITY BONDS?**

13 A. Yes. As more fully explained by Public Staff witness Schoenblum, there
14 are built-in “checks and balances” because the Commission retains full
15 regulatory review of the utility’s costs and the Utility can achieve its allowed
16 returns for shareholders to whom they have a fiduciary duty.

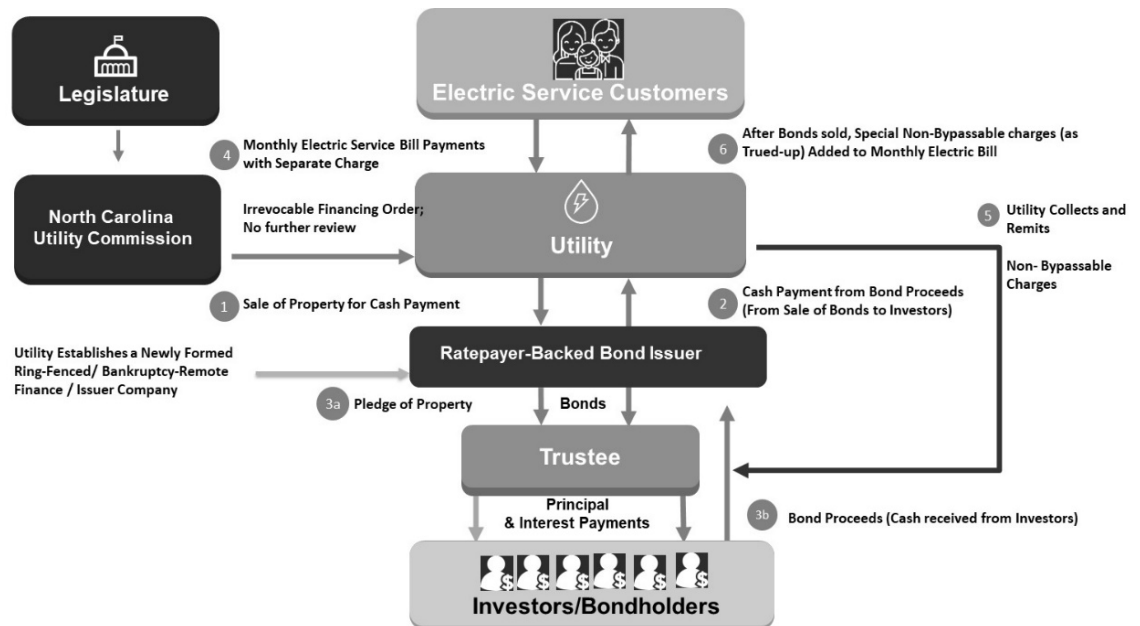


2 When a utility decides to issue a traditional bond, the utility has a strong
3 incentive to negotiate hard with underwriters for the lowest possible interest
4 rates as well as the lowest possible underwriting fees. Utilities also have a
5 strong incentive to minimize other issuance costs. These same incentives
6 do not come into play in connection with Ratepayer-Backed Bonds.
7 In each case, underwriters act as middlemen between the utility issuing the
8 bonds and the investors. Investors seeking bonds look for the highest
9 return, and they weigh the lending rate against the risk. Through – and after
10 – the process, the Commission retains its regulatory review authority over
11 the utility’s cost of capital and may disallow any costs that it considers not
12 prudent, just or reasonable.

1 **Q. HOW IS A RATEPAYER-BACKED-BOND DIFFERENT?**

2 A. As illustrated by the chart below, the structure of the bond is
3 materially different, more complex than a traditional utility bond. The
4 bondholder is a creditor of a special issuer but with a dedicated and specific
5 charge on all ratepayers. None of the utility's creditors have a claim on
6 those revenues even in a bankruptcy. The utility, after receiving the
7 proceeds of the bond sale, in this case is merely acting as the "servicer" of
8 the Ratepayer-Backed Bonds. This means they simply calculate, charge,
9 bill and collect the revenue from ratepayers to repay the bonds on time.

10 *Fichera Figure 6*

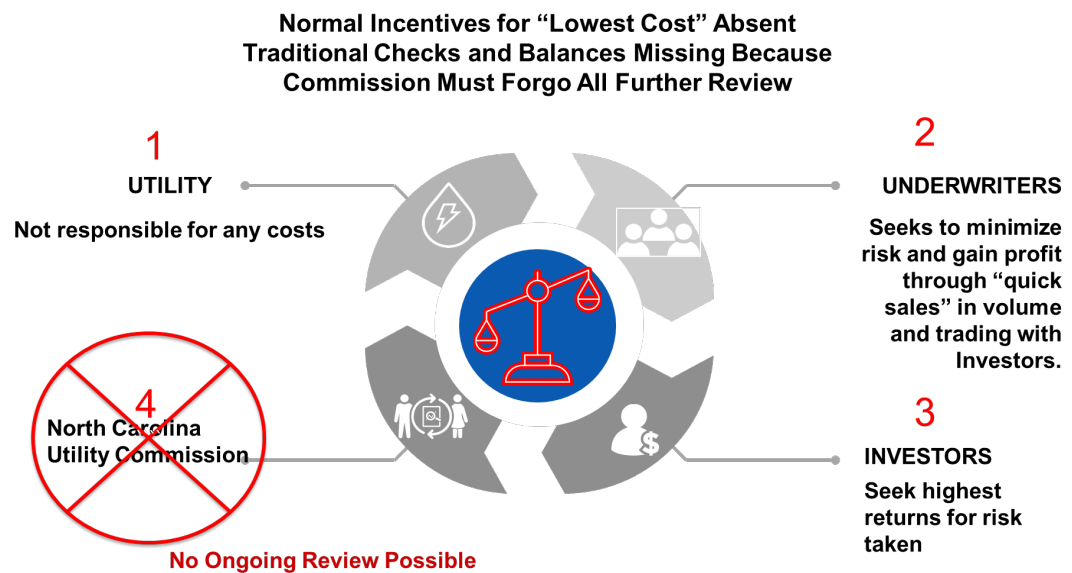


11

1 Q. ARE THERE THE SAME FINANCIAL INCENTIVES FOR THE
 2 UTILITY PRESENT IN A RATEPAYER-BACKED BOND THAT ARE
 3 PRESENT IN A TRADITIONAL BOND?

4 A. No. The issuer of Ratepayer-Backed Bonds is a new entity
 5 established for the sole purpose of selling the Ratepayer-Backed Bonds,
 6 not the utility. The only collateral this new issuer has to pledge to investors
 7 is the storm recovery property created by the statute and the Financing
 8 Order that contains the True-Up Mechanism and the state pledge of non-
 9 interference in the rights of the bondholders to be repaid on time.

10 *Fichera Figure 7*



11
 12 The testimonies of Public Staff witnesses Hyman, Schoenblum, and Klein
 13 explain in more detail why the interests of ratepayers and the sponsoring
 14 utility might not be aligned in the underwriting of Ratepayer-Backed Bonds.
 15 While the utility has a general business interest in keeping overall customer
 16 rates low, it will have no direct or indirect obligation to repay the Ratepayer-

1 Backed Bonds and will have no direct or indirect responsibility to pay any of
2 the financing costs. The ratepayers alone will bear all costs. Therefore, the
3 sponsoring utility may have no economic incentive to achieve the lowest
4 possible cost and the lowest possible storm recovery charges, although it
5 may have other incentives, such as a corporate policy, to achieve the
6 “lowest costs.”

7 That said, the sponsoring utility’s highest priority will likely be to get the
8 issuance done quickly, and cost may take a lower priority.

9 **Q. WOULD GRANTING THE COMPANIES “FLEXIBILITY” IN THE**
10 **FINANCING ORDER SOLVE THE PROBLEM?**

11 A. It solves one problem and creates another. With flexibility, the
12 outcome that the Commission expects at the time it issues the Financing
13 Order could change dramatically and materially for reasons both within and
14 beyond the control of the Companies. The Companies recognize this and
15 have proposed an Issuance Advice Letter process in Phases Two and
16 Three where only one Designated Commissioner would be involved - at a
17 very high level - during the Phase Two process following the issuance of
18 the Financing Order as the bonds are structured, marketed and priced. This
19 is when many material decisions are made and the storm recovery charges
20 and the Commission are locked in. The Companies would file an “Issuance
21 Advice Letter” at the end of Phase Three and propose that the full
22 Commission would be given the opportunity to disapprove the bond offering.

1 However, this would be after the Companies made all the decisions as to
2 the structure, marketing and pricing of the bonds. They would provide
3 “timely information” to the Commissioner and staff upon request.

4 **Q. ISN'T THAT SUFFICIENT?**

5 A. No. We agree that the Commission should make the final “go, no
6 go” decision. And we agree that there should be an Issuance Advice Letter
7 filed. But the process leading up to that final decision needs to produce an
8 informed and meaningful evidentiary record for the Commission to review
9 and consider. The Companies’ proposal excludes the representative of the
10 ratepayers, the Public Staff, from this important phase of the ratemaking
11 process. Moreover, it does not provide the Commission with independent
12 information and the analysis of technical information upon which to make
13 an informed decision. As explained by other Public Staff witnesses
14 Schoenblum, Klein, Sutherland, Maher and Abramson, the complexity of
15 the Ratepayer-Backed Bond structure, marketing and pricing process
16 requires the consideration and evaluation of specific and highly technical
17 information. It requires a robust process of due diligence so that the
18 Commission has a fully vetted evidentiary basis on which to make that final
19 “go, no go” decision. Anything less is insufficient.

20 For the Commission to make an independent “go, no go” decision, it needs
21 expert analysis of the information it receives. Simply being “informed” of
22 the decisions being made by the Companies, who have a direct financial

1 interest in the outcome that is different from the ratepayers, has been found
2 by many other state utility commissions to be an insufficient basis for
3 fulfilling their responsibilities to ratepayers.

4 It should be noted that capital market participants often have differing views
5 on the same information. That's what a market is by definition.

6 One caveat, however, is important. Parties who have a direct financial or
7 economic interest in the outcome may view certain information differently
8 from those who do not. If there were not differing and competing views
9 about the same information, there would not have been the significant
10 difference in investor orders for Ratepayer-Backed Bonds at proposed
11 yields that we have seen. So, the phrase "Trust but verify" applies.

12 **PRECEDENTS FROM OTHER STATES TO CONSIDER**

13 **Q. WHAT HAVE OTHER STATES DONE THAT THE COMMISSION**
14 **SHOULD CONSIDER?**

15 A. Over the past 20 years, certain "best practices" have emerged and
16 are discussed in more detail by Public Staff witnesses Klein, Schoenblum,
17 Sutherland and Heller. The first "best practice" is for the commission to
18 create a post Financing Order and pre-bond issuance review process. In
19 this process, the many technical and market-related issues raised in the
20 Joint Petition and by Public Staff in this testimony can be thoughtfully
21 considered and discussed by all parties affected by the transaction.
22 Following these proven "best practices" means amending the Companies'

1 proposal for “flexibility” to ensure that ratepayers are at the negotiating
2 table. Many years of experience have shown that it is essential that
3 ratepayers be on equal footing with the Companies, the underwriters and
4 the investors as post-Financing Order decisions are made about the final
5 structuring, marketing and pricing of the bonds. Every dollar in this
6 transaction is a ratepayer dollar. Being outside the negotiation room and
7 then being told “that’s the best we could do” is vastly different than being in
8 the room, at the table.

9 **Q. DOES N.C. GEN. STAT. § 62-172 AUTHORIZE THE NCUC TO**
10 **INCLUDE PROVISIONS IN A FINANCING ORDER THAT ARE**
11 **DESIGNED TO ENSURE THE LOWEST COST OF FUNDS AND OTHER**
12 **RATEPAYER PROTECTIONS?**

13 A. Yes. N.C.G.S. § 62-172(b)(3)b.12. directs the Commission to
14 include “any other conditions that the commission considers appropriate
15 and that are not otherwise inconsistent with this section.” This not only
16 authorizes, but directs the NCUC to impose conditions that are designed to
17 ensure the lowest possible storm-recovery charges and the greatest
18 possible ratepayer protections.

1 **Q. ARE ALL THE ELEMENTS FOR A SUCCESSFUL RATEPAYER-**
2 **BACKED BOND TRANSACTION PRESENT IN THE JOINT PETITION?**

3 A. No. There are both substantive and procedural deficiencies in the
4 Companies' Joint Petition that do not follow best practices. These
5 deficiencies are addressed in the testimony of Public Staff witnesses Klein
6 and Schoenblum and also later in my testimony. These deficiencies should
7 be addressed early so that the Commission, Public Staff and the
8 Companies can work in a cooperative manner to complete the transaction
9 expeditiously.

10 **COMMISSION AND PUBLIC STAFF INVOLVEMENT IN PHASES 2 & 3**
11 **OF THE PROCESS**

12 **Q. SHOULD THE COMMISSION ESTABLISH A PROCESS IN THE**
13 **FINANCING ORDER TO BE ACTIVELY INVOLVED IN THE SECOND**
14 **AND THIRD PHASES OF THIS TYPE OF BOND TRANSACTION THAN**
15 **IT IS IN TRADITIONAL UTILITY DEBT OFFERINGS?**

16 A. Yes. For example, without Commission oversight – with the use of
17 Public Staff and its own independent experts and advisors reviewing these
18 contracts and negotiations – there would be no advocate for the ratepayers
19 in the process. There would be no one with a fiduciary duty to work in the
20 best interests of ratepayers, as more fully explained by Public Staff witness
21 Maher. Traditional utility debt has the shareholders at risk and is subject to
22 ongoing review. The Companies have a fiduciary duty to their shareholders

1 while they are concerned about overall customer rates. In this transaction,
2 the Commission issues an irrevocable financing order. Once the storm
3 recovery bonds are issued, the ratepayer bears all the costs directly, and
4 those costs are not subject to Commission review. It bears repeating -
5 every dollar in this transaction is a ratepayer dollar directly.

6 **Q. HAVE OTHER STATE COMMISSIONS ENSURED THAT THE**
7 **FINANCING COSTS ASSOCIATED WITH RATEPAYER-BACKED**
8 **BONDS, INCLUDING THE INTEREST RATES AND ALL OTHER**
9 **FINANCING COSTS, RESULTED IN THE LOWEST OVERALL COST TO**
10 **RATEPAYERS AS A CONDITION OF THE FINANCING ORDER?**

11 A. Yes, but not all. As described in greater detail below in this
12 testimony, some other state commissions have made the decision to remain
13 active in the Second and Third Phases of the process with a lowest cost
14 objective. They generally have used active independent financial advisors
15 and counsel. These commissions have instructed those financial advisors
16 as well as commission staff, along with representatives of the sponsoring
17 utility, to take part actively and in advance in all aspects of the structuring,
18 marketing, and pricing of Ratepayer-Backed Bonds.

1 **Q. HOW HAVE OTHER STATE COMMISSIONS ENSURED THAT**
2 **THE LOWEST COST TO THE RATEPAYERS HAS BEEN ACHIEVED?**

3 A. Other state commissions with active financial advisors have
4 instructed those financial advisors as well as commission staff to participate
5 actively and in advance in all aspects of the structuring, marketing and
6 pricing of Ratepayer-Backed Bonds. This has included reviewing the
7 earliest drafts of transactions documents and initial contacts with rating
8 agencies as well as investor presentations and the actual negotiations with
9 underwriters at the moment of pricing of the Ratepayer-Backed Bonds.
10 Fundamentally, the Companies' Joint Petition asks for approval of costs
11 based on estimates with no procedure for independent confirmation that the
12 most important costs, the interest costs, are in fact the lowest possible for
13 the benefit of ratepayers.

14 **Q. OTHER PUBLIC STAFF WITNESSES RECOMMEND THAT THE**
15 **FINANCING ORDER ESTABLISH A "BOND TEAM" THAT INCLUDES**
16 **THE COMMISSION, PUBLIC STAFF AND THE COMPANIES TO**
17 **PARTICIPATE IN THE STRUCTURING, MARKETING, AND PRICING OF**
18 **STORM RECOVERY BONDS. DO YOU AGREE?**

19 A. Yes, I agree. Public Staff witnesses attest to this point in their
20 testimonies, as shaped by their own extensive experience.

1 THE FLORIDA PRECEDENT WITH DUKE ENERGY

2 Q. IN CONNECTION WITH THE ISSUANCE OF THE FIRST
3 SECURITIZED STORM RECOVERY BONDS FOR FLORIDA POWER
4 AND LIGHT IN 2007, DID THE FLORIDA PUBLIC SERVICE
5 COMMISSION (FPSC) FINANCING ORDER ESTABLISH A BOND TEAM
6 TO PARTICIPATE IN THE STRUCTURING, MARKETING AND PRICING
7 OF THOSE STORM RECOVERY BONDS?

8 A. Yes. The commission established a post Financing Order / pre-bond
9 issuance review process that included a Bond Team.” The commission’s
10 financing order came after a fully contested case and consideration of a
11 detailed record discussing the core issues of concern about ratepayers and
12 the utility’s response.

13 Q. WHEN DUKE ENERGY FLORIDA, LLC (DEF) APPLIED TO THE
14 FPSC FOR A FINANCING ORDER 10 YEARS LATER AUTHORIZING
15 THE ISSUANCE OF SECURITIZED RATEPAYER-BACKED BONDS, DID
16 DEF RECOMMEND THAT THE FPSC’S FINANCING ORDER
17 ESTABLISH A SIMILAR BOND TEAM TO PARTICIPATE IN THE
18 STRUCTURING, MARKETING AND PRICING OF THOSE RATEPAYER-
19 BACKED BONDS?

20 A. No, they did not.

1 Q. AS THE FPSC'S FINANCIAL ADVISOR IN THAT 2015 DEF
2 PROCEEDING, DID SABER PARTNERS RECOMMEND THAT THE
3 FPSC'S FINANCING ORDER DIRECT THAT A BOND TEAM BE
4 FORMED TO PARTICIPATE IN THE STRUCTURING, MARKETING AND
5 PRICING OF THOSE STORM RECOVERY BONDS?

6 A. Yes.

7 Q. HOW DID THE FPSC RESOLVE THIS DIFFERENCE IN
8 RECOMMENDATIONS OF DEF AND THE FPSC'S FINANCIAL
9 ADVISOR CONCERNING FORMATION OF A BOND TEAM?

10 A. There was a joint stipulation of all parties. Prior to a potentially
11 contested public hearing, DEF entered into the Proposed Stipulations on
12 Financing Order Issues, dated October 13, 2015, including Issue 39:

13 "DEF's customers will be effectively
14 represented throughout the proposed
15 transaction. DEF, its structuring advisor,
16 and designated Commission staff and its
17 financial advisor will serve on the Bond
18 Team. One designated representative of
19 DEF and one designated representative of
20 the Commission shall be joint decision
21 makers for all matters concerning the
22 structuring, marketing, and pricing of the
23 bonds except for those recommendations
24 that in the sole view of DEF would expose
25 DEF or the SPE to securities law and other
26 potential liability (i.e., such as, but not
27 limited to, the making of any untrue
28 statement of a material fact or omission to
29 state a material fact required to be stated
30 therein or necessary in order to make the
31 statements made not misleading) or
32 contractual law liability (e.g., including but

1 not limited to terms and conditions of the
2 underwriter agreement(s)). The final
3 structure of the transaction, including
4 pricing, will be subject to review by the
5 Commission for the limited purpose of
6 ensuring that all requirements of law and
7 the Financing Order have been met.”
8

9 Fichera Exhibit 3 to this testimony is a copy of these “Proposed Stipulations
10 on Financing Order Issues.” These stipulations are reflected in the FPSC’s
11 Financing Order for the 2016 DEF securitized storm recovery bond
12 transaction.

13 **Q. FOR THE TRANSACTION PROPOSED BY THE JOINT PETITION,**
14 **WITNESSES KLEIN, SCHOENBLUM, SUTHERLAND, ABRAMSON,**
15 **AND MAHER RECOMMEND THAT THE COMMISSION’S FINANCING**
16 **ORDER ESTABLISH A BOND TEAM WHICH INCLUDES PUBLIC STAFF**
17 **BUT DOES NOT INCLUDE UNDERWRITERS. DO YOU AGREE?**

18 A. Yes, I agree. Underwriters are on the other side of the negotiating
19 table. They should not be part of internal discussions among the
20 Companies, the Public Staff and the Commission concerning how the Bond
21 Team will negotiate with the underwriters about interest costs.

1 Q. THESE WITNESSES FURTHER RECOMMEND THAT THE BOND
2 TEAM BE A JOINT DECISION-MAKER WITH THE COMPANIES ON
3 MATTERS CONCERNING THE STRUCTURING, MARKETING AND
4 PRICING OF THE STORM RECOVERY BONDS. DO YOU AGREE?

5 A. Yes, I agree. It is just common sense as well as a proven “best
6 practice.” The party that pays the bills and the party that must approve the
7 transactions should be part of the decision-making process.

8 Q. WAS A DESIGNATED COMMISSIONER INVOLVED IN THE
9 FLORIDA BOND TEAM?

10 A. Yes. Because there could be competing views in which a consensus
11 might not be reached (as in all committees), the DEF / FPSC Bond Team
12 provided for a designated Commissioner to be a member of the Bond Team,
13 with authority to cast the deciding vote if other members of the Bond Team
14 did not agree on any aspect of the structuring, marketing or pricing of the
15 Ratepayer-Backed Bonds. However, this aspect of the Florida Bond team
16 was never invoked because a consensus was reached on all aspects of the
17 structure, marketing and pricing of the bonds.

1 **Q. DO YOU RECOMMEND THAT THE FINANCING ORDER IN THIS**
2 **PROCEEDING INCLUDE A SIMILAR DECISION-MAKING PROCESS**
3 **WITHIN THE BOND TEAM?**

4 A. Yes. I recommend that the Commission's Financing Order in this
5 proceeding provide for a designated Commissioner to be a member of the
6 Bond Team, with authority to cast the deciding vote if other members of the
7 Bond Team do not agree on any aspect of the structuring, marketing or
8 pricing of the storm recovery bonds.

9 **THE COMPANIES BELIEVE THAT THE FLORIDA PRECEDENT**
10 **SHOULD NOT BE FOLLOWED**

11 **Q. IN HIS RESPONSE TO A PUBLIC STAFF DATA REQUEST, THE**
12 **COMPANIES' WITNESS ATKINS STATES: "PURSUANT TO**
13 **SECURITIES LAWS, DEP AND DEC WILL BE THE ISSUERS OF STORM**
14 **RECOVERY BONDS AND ANY SRB SECURITIES WITH LIABILITY**
15 **UNDER FEDERAL AND STATE SECURITIES LAWS. THEREFORE,**
16 **THERE IS NO 'SYMMETRY' AND IT IS NOT CORRECT TO COMPARE**
17 **THE ROLE OF DEP AND DEC AS PART OF ANY BOND TEAM, TO THE**
18 **EXTENT THERE IS A BOND TEAM, AND PUBLIC STAFF." DO YOU**
19 **AGREE?**

20 A. No. This is a distinction without a difference. As summarized above,
21 DEF made essentially this same argument to the Florida Commission in
22 connection with Ratepayer-Backed Bonds issued for DEF in 2016. But DEF

1 ultimately stipulated in that proceeding that other participants in the Bond
2 Team may be joint decision makers with DEF on all matters related to the
3 structuring, marketing and pricing of those Ratepayer-Backed Bonds. The
4 only exclusion was “except for those recommendations that in the sole view
5 of DEF would expose DEF or the SPE to securities law and other potential
6 liability (i.e., such as, but not limited to, the making of any untrue statement
7 of a material fact or omission to state a material fact required to be stated
8 therein or necessary in order to make the statements made not misleading)
9 or contractual law liability (e.g., including but not limited to terms and
10 conditions of the underwriter agreement(s)).” Saber Partners recommends
11 that similar provisions be included in the Commission’s financing order in
12 this proceeding assuming the Companies will be following the established
13 precedents from the DEF transaction.

14 **UNDERSTANDING UNDERWRITER INTERESTS IN THE**
15 **TRANSACTION**

16 **Q. IS THERE ANYTHING ABOUT THE STRUCTURE OF**
17 **INVESTMENT BANKING FIRMS THAT SERVE AS UNDERWRITERS**
18 **THAT THE COMMISSION SHOULD KNOW AND CONSIDER IN**
19 **EVALUATING THE JOINT PETITION?**

20 A. Yes. It is important to understand that underwriting firms are not
21 monoliths – single units all working together. They are organized into
22 different divisions, each managed and evaluated as a separate profit and
23 loss center. The compensation of investment bankers results from the

1 separate results of these different divisions. The divisions have different
2 customers. The banking division is distinct from the sales and trading
3 division. Within the sales and trading division, there is usually a distinction
4 between institutional and retail sales. Institutions are large money
5 managers.

6 Because income and profit come from transactions, there is tremendous
7 pressure to write “tickets,” to conduct transactions – and to do so quickly.
8 No bond sales and trading division that I know or have ever heard of is on
9 retainer, i.e., is paid a fee not associated with a transaction. Consequently,
10 the incentive is the more transactions a division completes, the quicker the
11 sales, the more income and profit there is to share among employees of
12 that division.

13 Divisions within an investment bank are further organized on the basis of
14 securities “products” they underwrite or trade. One of the biggest challenges
15 we have encountered with Ratepayer-Backed Bonds is getting the attention
16 and focus of the appropriate divisions across the banks to assist in
17 distributing the bonds at the lowest cost to ratepayers.

18 Public Staff witness Heller, who also worked in large underwriting firms
19 discusses this in more detail.

20 **Q. HOW IS THIS RELEVANT TO THE JOINT PETITION?**

21 A. The Joint Petition proposes a process that relies heavily on the
22 “professional judgement” of underwriters to achieve the lowest storm
23 recovery charges to ratepayers. It is very light on discussion of how to gain

1 the greatest value from the Financing Order from investors. However, the
2 salespeople and the traders who buy the bonds from the issuer to re-sell
3 the storm recovery bonds to their investor clients do not have a duty to act
4 in the best interests of the ratepayer. That's not their job despite the
5 Companies assertion. Their job is described in their underwriting
6 agreement as witness Maher discusses in more detail and explains what
7 that means for ratepayers in this transaction.

8 It has been my experience both as an employee of major investment banks
9 for 17 years as well as in conversations, discussions with individuals
10 currently employed at major investment banks, that they are compensated
11 by re-selling securities and re-selling them quickly. Their primary clients are
12 investors who are in the market frequently buying and selling securities.
13 This "flow" of transactions is critical to the financial interests of the firm and
14 the individuals. Underwriters depend on these investors on a daily basis
15 versus the infrequent issuer of Ratepayer-Backed Bonds. Remember, in
16 the past 5 years only 3 of these transactions came to market. It just does
17 not get the focus of the firm in a way that benefits ratepayers when a new
18 transaction comes to market.

19 The Companies conceded in a response to a Public Staff data request that
20 underwriters, as do all participants in financing transactions, work in their
21 own best interests consistent with the contractual and legal obligations
22 under which they operate. As Public Staff witness Maher points out, their

1 contractual and legal obligations are clearly explained and do not include
2 the best interests of the ratepayers.

3 **Q. WHAT IS THE DIFFERENCE BETWEEN SALESPEOPLE AND**
4 **TRADERS?**

5 A. Salespeople interact with investors directly, like an individual's
6 personal broker. Traders decide how to use the investment bank's capital
7 to buy and sell securities for the investment bank's own account. Traders
8 decide on the actual prices and yields at which they are willing to purchase
9 or sell fixed-income debt securities.

10 There is a plethora of products, and both traders and investors have limited
11 time. The compensation system for both salespeople and traders
12 encourages efficiency – make the maximum amount of profit for the division
13 of the investment bank in the year and be paid “on performance.”
14 Performance (profit) is the bottom-line.

15 **Q. WHAT IS THE BIGGEST CHALLENGE IN DEALING WITH**
16 **UNDERWRITERS?**

17 A. The biggest challenge is getting underwriters to spend the time and
18 energy to create maximum value for the ratepayer. I know it can be done
19 because I have seen it from both sides - both as an underwriter and as
20 financial advisor to issuers and to regulators. It just is not easy. The

1 pressure is to do the deal, to take the offer that is already on the table.
2 Volume and spread are the key drivers.

3 **BEST PRACTICES: RECOMMENDED PROCEDURES**

4 **Q. WHAT ARE THE MOST IMPORTANT BEST PRACTICES FOR**
5 **NORTH CAROLINA'S FIRST RATEPAYER-BACKED BOND**
6 **TRANSACTION AND IN ESTABLISHING A PROGRAM?**

7 A. Following proven best practices would benefit North Carolina
8 ratepayers in establishing the proposed storm recovery bond program and
9 in the initial public offering of Ratepayer-Backed bonds as witnesses
10 Abramson, Klein, Schoenblum, Maher and Sutherland have explained. The
11 ones I would highlight are:

12 1. The Commission should use its authority to include terms and conditions
13 in the Financing Order to protect the ratepayer in structuring, marketing
14 and pricing the storm recovery bonds.

15 2. The Commission and ratepayer advocates need to collaborate with the
16 Companies and additional members of a Bond Team to ensure they
17 achieve a "lowest storm recovery charge" standard, relying on the
18 expertise of independent financial advisors like Saber Partners to
19 discern just how that can be achieved. Independent means no financial
20 interest in the bond proceeds or the bonds themselves and with a duty
21 to loyalty– a fiduciary responsibility to the ratepayer – the Commission
22 and the Public Staff.

1 3. After pricing but before closing, the Companies, the Underwriters and
2 the Public Staff's financial advisor each should certify that the lowest
3 storm recovery charge standard has been achieved, so the Commission
4 has time to stop the transaction if it determines that standard is not
5 achieved.

6 **COMMENT ON THE COMPANIES' RESPONSES TO CERTAIN DATA**
7 **REQUESTS**

8 **Q. IN THE JOINT PETITION AND IN RESPONSES TO PUBLIC**
9 **STAFF'S DATA REQUESTS, DID ANYTHING SURPRISE YOU?**

10 A. Yes. The Companies failed to recommend that the Commission
11 follow many of the best practices that DEF agreed to be included in the 2015
12 securitization Financing Order issued by the FPSC.
13 For example, that 2015 FPSC Financing Order required that the "marketing"
14 (as well as the "structuring" and "pricing") of the Ratepayer-Banked Bonds
15 result in the lowest securitization charge consistent with market conditions
16 at the time of pricing. Here, the Companies propose that the "lowest storm
17 recovery charge" standard be based only on "structuring and pricing"
18 without regard to "marketing" efforts in connection with the proposed storm
19 recovery bonds. This does not make sense. Consider the analogy of a
20 family selling its home. Does the family list with only one broker or many?
21 How are potential buyers should be contacted? How does the family
22 present the home? The best price the family will get will be determined by
23 how well the house is marketed. If the family just wants to sell quickly and

1 does not care about getting the best price, then the family will likely sell the
2 home quickly. Here, we have a duty to get the ratepayer the lowest cost on
3 a bond structure that has been infrequently sold and is not well understood,
4 so marketing will be essential. For the Companies to leave “marketing” out
5 of their proposal – even though it was included in the successful FPSC
6 Financing Order issued to DEF – is a major deficiency and should be
7 corrected.

8 As a second example, as financial advisor to the FPSC and to other
9 regulators in connection with other prior Ratepayer-Backed Bond
10 transactions, Saber Partners pioneered the practice of requiring
11 certifications or opinions in writing, without material qualifications,² from
12 underwriters. These written certifications say the structuring, marketing and
13 pricing of Ratepayer-Backed Bonds in fact resulted in the lowest
14 securitization charges consistent with market conditions at the time of
15 pricing and the terms of the Financing Order. The Companies do not
16 propose that underwriters be required to deliver such certifications or
17 opinions. For additional information about these compliance certifications,
18 see the testimony of Public Staff witnesses Schoenblum and Moore.

² Despite an explicit lowest cost standard in the New Jersey statute, from 2001 - 2004, the utilities, Underwriters, and the New Jersey Commission's financial advisors were allowed to place significant qualifications in their “lowest cost” certifications. In contrast, for the 2005 transaction for the benefit of Public Service Electric & Gas (PSE&G), the New Jersey Commission and its financial advisor eliminated these significant qualifications by adopting the Texas Commission financing order certification model. As shown on Sutherland Exhibit 4, the Spread for the 2005 PSE&G transaction was considerably tighter (i.e., less expensive to ratepayers) than any previous Ratepayer-Backed Bond transaction completed in New Jersey. See Staff Issues Decision Memoranda Document # 04068 May 9, 2006 in Docket No. 060038-EI- Petition for issuance of a storm recovery financing order by Florida Power & Light Company.

1 One key aspect of a written certification is not to have any “material
2 qualifications.” This means statements, conditions or assumptions that
3 dilute the meaning and intent of the certification or opinion. In its 2006 FP&L
4 storm securitization Financing Order, the FPSC examined certifications that
5 New Jersey Board of Public Utilities required of its financial advisor on
6 Ratepayer-Backed Bond offerings versus certifications the PUCT required
7 of its financial advisor. It found that the New Jersey form of certification was
8 weakened by the qualifications the advisor put in the certification. When
9 the Ratepayer-Backed Bond pricings of New Jersey and Texas were
10 compared – though each had certification letters – the Texas transactions
11 got consistently lower credit spreads to benchmark issues. This meant
12 Texas ratepayers paid less and indeed got the lowest costs and lowest
13 securitization charge at the time of pricing. A study of Texas versus New
14 Jersey Ratepayer-Backed Bond pricings by Barclays Bank in 2005
15 confirmed this outcome. A copy of that study was provided to Saber
16 Partners.

1 Q. WAS IT EASY TO PERSUADE UNDERWRITERS TO DELIVER
2 THOSE CERTIFICATIONS FOR THE 2016 DEF TRANSACTION OR
3 OTHER PRIOR RATEPAYER-BACKED BOND TRANSACTIONS
4 WHERE SABER SERVED AS FINANCIAL ADVISOR TO THE
5 REGULATOR?

6 A. No. Underwriters were concerned about their liability from making
7 the certification.

8 Q. WAS THAT A VALID CONCERN?

9 A. Yes, in part. It was the driving motivation for Saber Partners to seek
10 the confirming certification or opinion. It is relatively easy for bond issuers
11 to get underwriters to say something orally about market conditions and the
12 results of the underwriters' efforts in structuring, marketing and pricing
13 publicly-offered securities. It is another thing to get the underwriters to "put
14 that that in writing."

1 Q. AFTER THE PRICING OF THE STORM RECOVERY BONDS, THE
2 COMPANIES ARE CALLED UPON TO CERTIFY THAT THE
3 STRUCTURING AND PRICING OF THE BONDS RESULTED IN THE
4 LOWEST STORM RECOVERY CHARGES CONSISTENT WITH
5 MARKET CONDITIONS AT THE TIME (SEE PROPOSED FINANCING
6 ORDER, APPENDIX C). WHY IS IT IMPORTANT THAT THE
7 COMPANIES DELIVER THESE CONFIRMING CERTIFICATIONS?

8 A. Representatives of the Companies will be involved in the decisions
9 related to the structuring, marketing and pricing of storm recovery bonds. It
10 is only prudent to expect that the Companies, as Joint Petitioners, will also
11 deliver certificates confirming that the “lowest storm recovery charge”
12 requirement set forth in the Financing Order has, in fact, been met.

13 Q. IS THE FINANCING ORDER PROPOSED BY THE JOINT
14 PETITION AMBIGUOUS CONCERNING WHETHER THE COMPANIES
15 WILL BE REQUIRED TO DELIVER THESE CONFIRMING
16 CERTIFICATIONS?

17 A. Yes. Public Staff witness Schoenblum’s testimony reinforces this.

1 Q. DO YOU ALSO AGREE THAT THAT IT IS APPROPRIATE FOR
2 THESE CERTIFICATIONS TO CONFIRM THAT “MARKETING” OF THE
3 STORM RECOVERY BONDS RESULTED IN THE “LOWEST STORM
4 RECOVERY CHARGE”?

5 A. Yes. Public Staff witnesses Schoenblum and Klein concur.

6 Q. IN RESPONDING TO A PUBLIC STAFF DATA REQUEST,
7 COMPANIES WITNESS ATKINS STATED THAT THE DRAFT
8 FINANCING ORDER FOR THE PROPOSED DEC AND DEP
9 TRANSACTION WERE DESIGNED TO COMPLY WITH THE NORTH
10 CAROLINA STATUTORY REQUIREMENTS, WHICH DID NOT INCLUDE
11 A ROLE FOR A DESIGNATED REPRESENTATIVE IN THE POST-
12 FINANCING ORDER DECISIONS CONCERNING THE ‘MARKETING’ OF
13 THE SECURITIES BEING OFFERED IN THE TRANSACTION. HE WENT
14 ON FURTHER TO STATE THAT COMPARISONS TO THE 2016 DEF
15 TRANSACTION ARE NOT APPROPRIATE AS THAT TRANSACTION
16 CONCERNED A DIFFERENT UTILITY REGULATED BY A DIFFERENT
17 COMMISSION UNDER A DIFFERENT STATUTE. DO YOU AGREE WITH
18 WITNESS ATKINS?

19 A. No. Relevant provisions of the Florida statute and the North Carolina
20 statute are essentially the same.

21 F.S. § 366.95(2)(c)2. states:

22 **In a financing order issued to an electric**
23 **utility, the commission shall:**

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b. Determine if the proposed structuring, expected pricing, and financing costs of the nuclear asset-recovery bonds have a significant likelihood of resulting in lower overall costs or would avoid or significantly mitigate rate impacts to customers as compared with the traditional method of financing and recovering nuclear asset-recovery costs. . . .;

* * *

i. Include any other conditions that the commission considers appropriate and that are authorized by this section.”

N.C.G.S. § 62-172(b)(3)b. states:

“A financing order issued by the Commission to a public utility shall include all of the following elements:

* * *

3. A finding that the structuring and pricing of the storm recovery bonds are reasonably expected to result in the lowest storm recovery charges consistent with market conditions at the time the storm recovery bonds are priced and the terms set forth in such financing order.

* * *

12. Any other conditions not otherwise inconsistent with this section that the Commission determines are appropriate.”

1 Q. PUBLIC STAFF WITNESSES SCHOENBLUM AND KLEIN
2 TESTIFY THAT, IN THEIR VIEW, THE COMMISSION SHOULD REQUIRE
3 THESE CONFIRMING “LOWEST STORM RECOVERY CHARGE”
4 CERTIFICATIONS NOT ONLY FROM THE COMPANIES, BUT ALSO
5 FROM THE BOOKRUNNING UNDERWRITER(S) AND FROM THE
6 COMMISSION’S OR PUBLIC STAFF’S INDEPENDENT FINANCIAL
7 ADVISOR. IF THE COMPANIES DELIVER THESE CERTIFICATIONS,
8 WHY ARE “LOWEST STORM RECOVERY CHARGE” CERTIFICATIONS
9 ALSO NEEDED FROM THE BOOKRUNNING UNDERWRITER(S) AND
10 AN INDEPENDENT FINANCIAL ADVISOR?

11 A. An independent certification from someone with a duty to the
12 ratepayers – the party that is paying the costs - is prudent and consistent
13 with how many other financial transactions are done. By law, after the
14 storm recovery bonds are issued and the Companies receive the net
15 proceeds, there is no further review of the transaction possible by the
16 Commission. The Companies have a financial incentive to receive the
17 proceeds as quickly and effortlessly as possible, with no liability for the
18 resulting storm recovery charges and arguably no liability in giving these
19 certifications. And the Companies might truly believe they got the best deal.
20 However, despite their best efforts, the Companies might not have access
21 to all information that is material to determining whether the “lowest storm
22 recovery charges” in fact were achieved. This is particularly true of
23 information about communications between the underwriters’ salespersons

1 and potential investors, both on the day of pricing and also during the weeks
2 leading up to pricing. For that reason, in my view, it also is important that
3 the bookrunning underwriter(s) also deliver a “lowest storm recovery
4 charge” certification after the storm recovery bonds are priced and before
5 they are issued.

6 **Q. IN RESPONSE TO A PUBLIC STAFF DATA REQUEST, WITNESS**
7 **HEATH STATED THAT THE SRB SECURITIES WILL NOT BE ISSUED**
8 **BY CUSTOMERS, SO IT IS INAPPROPRIATE TO SUGGEST THAT**
9 **CUSTOMERS WOULD NEGOTIATE WITH UNDERWRITERS. HE WENT**
10 **ON TO STATE THAT THE COMPANIES ARE NOT AWARE OF ANY**
11 **SECURITIES OFFERINGS WHERE RATEPAYERS NEGOTIATED**
12 **DIRECTLY WITH UNDERWRITERS. DO YOU AGREE?**

13 A. No. That is a distinction that is without a difference. Newly-formed
14 limited purpose subsidiaries will be the issuers of storm recovery bonds,
15 and a grantor trust wholly-owned by Duke Energy Corporation would be the
16 issuer of any SRB Securities. The issuers will be responsible to pay all debt
17 service and other financing costs with respect to the storm recovery bonds
18 – but only from specifically identified resources that will consist principally
19 of storm recovery charge collections from customers. The transaction will
20 be set up so that debt service and other financing costs will be a complete
21 passthrough to the ratepayer. Investors cannot look to DEC, DEP or Duke
22 Energy Corporation to get a penny. Investors may look only to the issuers,

1 and the issuers will be obligated to make payments only to the extent of
2 amounts held by a bond trustee in a "Collection Account" which will consist
3 principally of collections of storm recovery charge revenues from
4 customers. In addition, the issuers will own storm recovery property, which
5 includes the right to bill, charge and collect storm recovery charges and to
6 require the Commission to adjust the storm recovery charge to whatever
7 level is necessary to repay the investors on time.

8 This is fundamentally different from when the Companies themselves issue
9 debt securities. There the bondholders can go after the assets of the entire
10 operating utility company if it's a first mortgage bond. Unsecured creditors
11 might have to wait in line, but they can sue the operating utility for payment.
12 Bankruptcy is a real risk for operating utilities. Neither DEC nor DEP can
13 force the Commission to raise customer rates immediately and to whatever
14 level might be necessary to pay their creditors. It is just not the same.

15 **Q. DO YOU HAVE ANY CONCERNS WITH THE PROPOSED**
16 **GRANTOR TRUST STRUCTURE THAT COMPANIES WITNESS**
17 **ATKINS PROPOSES TO BE USED THAT COMBINES THE STORM**
18 **RECOVERY BOND ISSUANCES OF BOTH DUKE ENERGY**
19 **CAROLINAS AND DUKE ENERGY PROGRESS INTO A SINGLE**
20 **SECURITY?**

21 A. I believe all options should be explored that may produce the lowest
22 cost to the ratepayer. However, the structure has only been used once in

1 the last 15 years, and that was for FirstEnergy of Ohio. Other utilities in
2 Louisiana and West Virginia that have two affiliated companies with the
3 option of using that structure did not choose it. I believe it adds a layer of
4 complexity to the sale of the Ratepayer-Backed Bonds that may cost
5 ratepayers more. While the Companies believe that it is not complex, the
6 lead bookrunning manager and structuring advisor of the FirstEnergy of
7 Ohio transaction (Goldman Sachs) informed the Companies (in their
8 response to the Companies request for proposals for a structuring advisor)
9 that they did not recommend the structure for the Companies and called the
10 grantor trust bond structure “complex.”

11 Moreover, according to a report by FirstSouthwest (attached to this
12 testimony as Fichera Exhibit 4), the independent financial advisor to the
13 Public Utility Commission of Ohio on the transaction at the time, there were
14 only eight investors in each of the tranches of the \$444 million Ratepayer-
15 Backed Bond issuance. Notably, that transaction did not have a lowest cost
16 to the ratepayer standard in the authorizing legislation nor the Financing
17 Order authorizing the Ratepayer-Backed Bond sale. These facts raise
18 serious questions as to whether this structure would be in the best interest
19 of the Companies’ ratepayers.

20 Finally, the main reason cited by witness Atkins for using the combined
21 grantor trust structure – to make the bonds eligible in size for inclusion in
22 the Bloomberg Barclays Aggregate Bond Index” - is dubious at best. There
23 is no supporting evidence that this index, as opposed to other indices

1 followed by utility and corporate bond investors, would have any effect on
2 lowering the interest rate on the bonds. A review of witness Atkins' previous
3 testimony on behalf of other utilities in Ratepayer-Backed Bond transactions
4 found no mention of the "Aggregate Bond Index" as a material factor in
5 structuring, marketing or pricing the bonds. The Companies did admit that
6 the Corporate Utilities Bond Index was an important factor that could lower
7 ratepayer costs. However, to be eligible for the Aggregate Bond Index the
8 Companies would have to promote the storm recovery bonds as "asset
9 backed securities" even though the Companies say the storm recovery
10 bonds would be structured like the DEF bonds as "not asset-backed
11 securities as defined by SEC Regulation AB." So, besides complexity, the
12 approach seems to add confusion. Neither of these will likely lower
13 ratepayer costs in negotiations with investors.

14 If the Commission's Financing Order allows the possibility for using a
15 grantor trust structure, however, this structure should be studied by the
16 proposed Bond Team with further analysis by Public Staff and its
17 independent advisor, given the lack of any evidence supporting the value of
18 such an option.

1 **Q. WHY IS MARKETING SO IMPORTANT? DO NOT MOST MAJOR**
2 **UNDERWRITERS AND INVESTORS UNDERSTAND WHAT**
3 **RATEPAYER-BACKED BONDS ARE SO THAT VERY LITTLE TIME**
4 **NEEDS TO BE SPENT ON INVESTOR EDUCATION?**

5 A. Because Ratepayer-Backed Bond issuances have been infrequent
6 and often mischaracterized by Underwriters and others, I do not believe
7 there is a thorough understanding of the nature of the credit so that they are
8 properly valued. The best example of the confusion associated with
9 Ratepayer-Backed Bonds is a research report that was done by Wells Fargo
10 in 2013 (attached as Fichera Exhibit 5). Wells Fargo was a co-managing
11 Underwriter on an Ohio Power Ratepayer-Backed Bond offering and was
12 the sole Underwriter of the Florida Power & Light storm securitization bonds
13 in 2007. However, the research report described the transaction as a “utility
14 receivables” transaction. Receivables are a core part of the “asset-backed
15 securities” market and involve many complexities and risks. However,
16 receivables are not part of any Ratepayer-Backed Bond structure. There
17 are no receivables pledged to the bondholders or part of the collateral for
18 the bonds.
19 Directly on point, for example, the prospectus for the Florida Power & Light
20 storm recovery bond transaction stated that “[s]torm-recovery property is
21 not a receivable, and the principal credit supporting the related series of

1 bonds is not a pool of receivables.”³ The same will be true with North
2 Carolina storm recovery property. Witness Heller discusses this investor
3 and underwriter confusion in his testimony. This is one of the reasons he
4 says they should not be treated as “asset-backed securities.”
5 But, the fact that a major investment banking firm in a 10-page report
6 described it as a “utility receivables” transaction is a concern and a
7 challenge. While the report got many things right, it got this core issue
8 wrong. This is symptomatic of a larger marketing problem that we have
9 confronted over and over again in the 20 years that Saber Partners has
10 been involved in the Ratepayer-Backed Bond market. Underwriters are not
11 familiar with the structure and attempt to use shorthand or comparisons to
12 things they are familiar with but are not part of the unique and extraordinary
13 security that a Ratepayer-Backed Bond has. While the rating agencies dryly
14 describe accurately the structure and credit, salespeople often get it wrong.
15 That is another reason why a representative of the ratepayer needs to be
16 at the negotiating table and why the Bond Team proposal is a best practice.

17 **COMPARISON TO OTHER SECURITIES RELEVANT TO**
18 **CONSIDERING THE JOINT PETITION**

19 **Q. IS A COMPARISON TO OTHER SECURITIES IMPORTANT TO**
20 **RATEPAYERS?**

21 A. Yes. As discussed in greater detail by Public Staff witnesses
22 Schoenblum, Sutherland, Heller, Abramson and Maher, it is important to

³ https://www.sec.gov/Archives/edgar/data/37634/000090514807003876/efc7-1376_424b5.txt at page 6.

1 compare storm-recovery bonds to other comparable securities in the market
2 to determine whether ratepayers have received all the benefits from
3 securitized storm recovery bonds, the legislation and the Financing Order,
4 and to have a benchmark for success. All securities price in relation to other
5 securities. Only by knowing and examining these and other factors can one
6 determine whether a Ratepayer-Backed Bond transaction has been
7 successful or not.

8 **Q. PUBLIC STAFF WITNESSES HELLER AND SUTHERLAND**
9 **RECOMMEND THAT THE STORM RECOVERY BONDS BE**
10 **STRUCTURED AND MARKETED AS “CORPORATE DEBT**
11 **SECURITIES” AND NOT AS “ASSET-BACKED SECURITIES.” DO YOU**
12 **AGREE?**

13 A. Yes, I agree.

14 **Q. HOW WILL MARKETING AND INVESTOR EDUCATION AFFECT**
15 **THE COST OF STORM-RECOVERY BONDS?**

16 A. As discussed in the testimony of Public Staff witness Schoenblum,
17 in issuing bonds, there are specific rules and regulations to follow,
18 disclosure and marketing documents to be filed with regulators, and the
19 bonds will compete with multiple alternative investment opportunities. But
20 investors' fundamental valuation comes from an understanding of the credit,
21 its liquidity, “relative value” and the functioning of the capital markets.

1 Accurate market education does not happen by itself. It usually occurs only
2 if undertaken and pursued vigorously by those who have a stake in the
3 outcome. For example, the Companies, as well as almost all other
4 corporations, spend a great deal of shareholder resources in promoting and
5 educating the market for their stock and their debt securities. The
6 management invests this time and energy because it believes that from true
7 market education and a better understanding of its company, the valuation
8 of the company's stock and debt securities will increase for the benefit of
9 shareholders. The management also targets efforts at lenders to lower the
10 company's borrowing costs because it expects to need debt capital on an
11 ongoing basis.

12 With storm-recovery bonds, because the Companies are not responsible for
13 any costs of borrowing, as it otherwise would be in a traditional debt offering,
14 the Companies have no immediate stake in the outcome other than to
15 receive the cash and improve their balance sheets as quickly as possible.
16 Moreover, the transaction is likely viewed from the Companies' perspective
17 as a one-time offering, or, at the very least, an infrequent offering, so their
18 need to make a concerted effort to educate the market regarding the
19 benefits of storm-recovery bonds is diminished.

20 While well intentioned, the Companies' management also is distracted by
21 independent concerns stemming from the fact that its current debt is a direct
22 burden on revenues that are available to its shareholders, and storm-
23 recovery bonds are not. Therefore, there is little incentive for the

1 Companies to invest time and effort in educating the market, expanding the
2 market, or creating as broad a competition as possible for this or other
3 storm-recovery bond issuances.

4 As the beneficiary of the storm-recovery bond issue, the Companies can
5 and should work collaboratively with the Commission, Public Staff and
6 advisors to achieve a successful lowest storm recovery charge and lowest
7 cost financing. The Bond Team process, with the Commission having
8 access to independent advisors with a duty of loyalty and care to the
9 ratepayer (in this case provided by Public Staff) , can and should take a co-
10 leadership role with the Companies in marketing and in investor education
11 efforts. A joint and collaborative effort can best serve the interests of
12 ratepayers while fully addressing the financing needs of the utility.

13 **IMPORTANCE OF PHASES 2 &3 STRUCTURING, MARKETING AND**
14 **PRICING**

15 **Q. HAVE COMMISSIONS IN OTHER STATES BEEN ACTIVELY**
16 **INVOLVED IN THE STRUCTURING, MARKETING, AND PRICING OF**
17 **THESE TRANSACTIONS AFTER THE ISSUANCE OF THE FINANCING**
18 **ORDERS?**

19 A. Yes. Commissions in Texas, Florida, West Virginia, New Jersey, and
20 California and Louisiana have been actively involved in the structuring,
21 marketing and pricing of Ratepayer-Backed Bonds. Significantly, the
22 California Public Utilities Commission, which was one of the first states to
23 sponsor Ratepayer-Backed Bonds, initially did not participate actively after

1 issuing its Financing Orders in 1997 and 1998. However, when a second
2 round of Ratepayer-Backed Bonds was authorized in 2004, the California
3 Commission created an active role for a Commission financing team to
4 approve post-Financing Order matters. They confirmed this role again in
5 November 2020 in a Financing Order for Southern California Edison
6 Company,⁴ the California Commission's first Financing Order in 16 years.
7 The PUCT has had the most active post-Financing Order participation.
8 Two transactions illustrate the results that can be achieved by an active and
9 involved commission in the structuring, marketing and pricing of Ratepayer-
10 Backed Bonds. In September 2005, Public Service Electric and Gas
11 Company of New Jersey sponsored the issuance of \$102 million of
12 Ratepayer-Backed Bonds. Saber served as financial advisor to the New
13 Jersey Commission, and Credit Suisse (CS) was the lead underwriter.
14 Normally a transaction of this size might have been difficult to sell because
15 of its small size relative to other competing investments.
16 However, according to a report written by CS to the New Jersey
17 Commission,

18 “The extensive marketing of these bonds
19 conducted by CS, Barclays and M.R. Beal,
20 with active participation by Saber, led to the
21 unprecedented (low) pricing spreads,
22 despite the disadvantage of relatively small
23 tranche sizes.”
24

⁴ See *California Current* CPUC Judge Adds Ratepayer Protections to \$337M SCE Bond
<http://cacurrent.com/subscriber/archives/41788>.

1 In December 2005, CenterPoint Energy of Texas initially offered \$1.2 billion
2 of Ratepayer-Backed Bonds to the market. Saber was the financial advisor
3 with joint decision-making responsibility with the issuer. The PUCT acted
4 by and through the financial advisor. CS was one of the bookrunning
5 underwriters. In this case, the large size of the transaction, coupled with
6 the timing of the issuance at the end of the year (which traditionally is not a
7 good time to sell securities) posed special challenges. Nevertheless, the
8 Ratepayer-Backed Bonds received worldwide investor demand at record-
9 low credit spreads. The transaction was increased to \$1.85 billion with over
10 one-third of the bonds being sold to foreign investors for the first time ever.
11 This transaction was also notable because of the large amount of bonds
12 sold with very long maturities which are the type of bonds most costly to
13 ratepayers. Yet, the credit spread levels achieved by the PUCT for
14 ratepayers through these Texas Ratepayer-Backed Bonds on the longest
15 maturities were significantly below all other previously offered Ratepayer-
16 Backed Bonds in any state.

17 **Q. IN TEXAS, DID SABER PARTNERS SERVE AS FINANCIAL**
18 **ADVISOR TO THE PUCT IN CONNECTION WITH \$1,739,700,000**
19 **PRINCIPAL AMOUNT OF RATEPAYER-BACKED BONDS ISSUED IN**
20 **2006 FOR AEP TEXAS CENTRAL COMPANY?**

21 A. Yes. That issuance of Ratepayer-Backed Bonds consisted of five
22 separate sequential-pay tranches. Each tranche was separately priced.

1 Attached as Fichera Exhibit 2 is a copy of page 49 of the “Pricing Book” for
2 that Ratepayer-Backed Bond transaction. This Pricing Book is dated
3 October 4, 2006, and was prepared by CS, the bookrunning underwriter, as
4 a report to the sponsoring utility and to the PUCT about the success in
5 pricing each of the five tranches.

6 **Q. WHEN THESE RATEPAYER-BACKED BONDS WERE PRICED,**
7 **AND THE UNDERWRITERS ENTERED INTO AN UNDERWRITING**
8 **AGREEMENT COMMITTING TO PURCHASE ALL \$1,739,700,000**
9 **PRINCIPAL AMOUNT OF RATEPAYER-BACKED BONDS, DID THE**
10 **UNDERWRITERS HAVE ORDERS FROM INVESTORS FOR ALL THESE**
11 **BONDS?**

12 A. No. At final pricing, page 49 of the “Pricing Book” Saber Partners
13 requested that the underwriters prepare to memorialize the transaction
14 process, reports that the underwriters had orders for more than 100% of
15 tranches 1, 2, 3 and 5, but for only 96% of tranche 4. Tranche 4 had a
16 weighted average life of 10.0 years and a principal amount of \$437,000,000.

1 Q. IF THE UNDERWRITERS WERE NOT ABLE TO FIND
2 INVESTORS BETWEEN PRICING AND THE OCTOBER 11, 2006
3 CLOSING DATE, WHO WOULD BE OBLIGATED TO PURCHASE THE
4 \$17,480,000 OF BONDS THAT HAD NOT BEEN PRE-SOLD TO
5 INVESTORS?

6 A. The underwriters would be required to use their own capital to
7 purchase this \$17,480,000 of bonds at the initial public offering price (less
8 the agreed upon underwriter's discount set forth in the Underwriting
9 Agreement).

10 Q. DID THE TEXAS SECURITIZATION STATUTE RESEMBLE N.C.
11 G.S. § 62-172 IN REQUIRING THAT THOSE RATEPAYER-BACKED
12 BONDS BE PRICED SO AS TO PRODUCE THE LOWEST
13 SECURITIZATION CHARGES CONSISTENT WITH MARKET
14 CONDITIONS AT THE TIME OF PRICING?

15 A. Yes. Section 39.301 of the Texas Public Utility Regulatory Act
16 states: "The commission shall ensure that the structuring and pricing of the
17 transition bonds result in the lowest transition bond charges consistent with
18 market conditions and the terms of the Financing Order."

1 Q. DID OUTSIDE LEGAL COUNSEL TO AEP TEXAS CENTRAL
2 DELIVER ITS OPINION THAT THOSE RATEPAYER-BACKED BONDS
3 WERE VALIDLY ISSUED?

4 A. Yes. A copy of that legal opinion delivered by Sidley Austin LLP was
5 filed with the SEC and can be found at
6 [https://www.sec.gov/Archives/edgar/data/18734/000119312506185414/de](https://www.sec.gov/Archives/edgar/data/18734/000119312506185414/dex51.htm)
7 [x51.htm](https://www.sec.gov/Archives/edgar/data/18734/000119312506185414/dex51.htm).

8 Q. IN RESPONDING TO A PUBLIC STAFF DATA REQUEST,
9 COMPANIES WITNESS ATKINS STATED THAT A MARKET-CLEARING
10 PRICING WOULD RESULT IN INTEREST RATES FOR THE SRB
11 SECURITIES THAT ARE CONSISTENT WITH MARKET CONDITIONS
12 AT THE TIME OF PRICING. HE WENT ON TO STATE THAT INTEREST
13 RATES THAT ARE SUBSIDIZED BY PRIVATE COMPANIES, WHETHER
14 UNDERWRITER FIRMS OR THE COMPANIES, THROUGH THE
15 PURCHASE OR RETENTION OF UNSOLD UTILITY SECURITIZATION
16 BONDS, ARE NOT CONSISTENT WITH MARKET CONDITIONS AT THE
17 TIME OF PRICING, AND THEREFORE INCONSISTENT WITH N.C. GEN.
18 STAT. § 62-172. DO YOU AGREE WITH WITNESS ATKINS?

19 A. No. I believe the Pricing Book for the 2006 AEP Texas Central
20 Ratepayer-Backed Bond transaction, together with the approving legal
21 opinion delivered by Sidley Austin LLP, illustrates that an underwriter's
22 purchase or retention of any unsold storm recovery bonds would be

1 consistent with market conditions at the time of pricing, and therefore
2 consistent with N.C.G.S. § 62-172.

3 **Q. DOES A “LOWEST COST” AND “LOWEST SECURITIZATION**
4 **CHARGE” STANDARD CREATE MORE COSTS FOR RATEPAYERS**
5 **THAN A LESSER STANDARD?**

6 A. No. As explained in the testimony of Public Staff witness
7 Schoenblum, pursuing a lowest cost and lowest securitization charge
8 standard might require transaction participants to work harder, but not at a
9 higher net economic cost. Hard work is an investment that always pays off.
10 Consider that the Companies propose almost \$12 million in issuance
11 expenses. It is appropriate to expect the best possible outcome for such
12 costs, especially from the underwriters. Otherwise, waste and inefficiency
13 might arise from the process. Indeed, not pursuing the lowest cost almost
14 guarantees higher costs to the ratepayer because there is no incentive or
15 accountability to get anything better.

16 Among the transaction costs, the greatest economic cost to ratepayers is
17 the interest rate on the bonds which ratepayers will be paying for the entire
18 term to maturity. This dwarfs any single up-front transaction cost. One
19 eighth of one per cent of \$1 billion outstanding for about 7.5 years will cost
20 ratepayers \$9.4 million in nominal dollars. For a longer maturities such as
21 up to 20 years, this amount would be even more. For the reasons outlined
22 in the testimony of Public Staff witness Schoenblum, “reasonable” is not an

1 appropriate standard to apply, especially when the potential cost is so
2 substantial. Moreover, without meaningful involvement in real time, there
3 will be no way for the Commission to know that the transaction was priced
4 at the lowest interest rate possible.

5 This is one reason why care needs to be taken, in cooperation with the
6 Companies, in selecting experienced transaction participants and others. It
7 is essential to put together a team which shares a similar objective and
8 commitment to excellence, which can provide economies of scale and
9 which is responsive to competitive pressures and economic incentives. If
10 the economic incentives are properly aligned with proper oversight, then
11 underwriters, counsel, advisors and others will work in the most cost-
12 effective, collaborative manner with the Commission and the Companies to
13 achieve the lowest storm recovery charge and lowest cost objective. If there
14 are inadequate incentives or accountabilities in the process, waste and
15 inefficiencies are likely to occur. The standard of “lowest cost” and “lowest
16 storm recovery charges” with accountability compels the transaction parties
17 to achieve the best transaction possible and to avoid a poorly executed,
18 badly priced transaction.

19 Some may argue that an active Commission increases utility legal costs and
20 that this is a reason not to have active Commission and Public Staff
21 involvement in protecting ratepayer interests after a Financing Order has
22 been issued. A review of past legal costs associated with all publicly-offered

1 Ratepayer-Backed Bonds with or without an active commission, Public
2 Staff, or an advisor shows no discernible pattern.

3 **Q. IS THE LENGTH OF TIME IT TAKES TO COMPLETE A**
4 **TRANSACTION A FAIR MEASURE OF SUCCESS IN RATEPAYER-**
5 **BACKED BOND TRANSACTIONS?**

6 A. No. As Public Staff witness Schoenblum testifies, the length of a
7 transaction depends on many factors, such as the speed of the rating
8 agencies' evaluations, efficiency of the underwriters in developing the
9 marketing plan, whether new markets or marketing strategies are being
10 developed, and whether the utility and underwriters work collaboratively
11 with the commission, the ratepayer advocate, and financial advisors in
12 assisting the commission in its oversight function. In some cases,
13 Ratepayer-Backed Bond transactions have been delayed significantly by
14 appeals of the Financing Orders. In other cases, the rating agencies and
15 securities registration processes have been the most time-consuming
16 aspects of a transaction. However, many items can be done concurrently.
17 The best measure of the effectiveness of a transaction is not how fast it is
18 completed, but what the ultimate value for ratepayers.

1 efficient results because each participant pursues its own economic
2 interest, with full knowledge and understanding of the transaction, so that
3 prices are determined through “perfect competition’ based on the free flow
4 of information.

5 However, to create the conditions for “perfect competition,” there needs to
6 be a balance of competing interests in any negotiation. In this transaction
7 as currently proposed by the Companies, the balance is not achieved.
8 Under the procedures proposed by the Joint Petition, the people
9 responsible for repaying the bonds, the ratepayers, are not represented at
10 the negotiating table. They are not protected. Unless the Commission acts
11 to create a process involving Public Staff and the Commission, the results
12 are likely to be skewed against ratepayers’ interests because that’s how the
13 capital markets work. And all top-rated securities, even AAA-rated
14 securities, do NOT price the same; there are differing views. Nothing is
15 automatic except that self-interest rules.

16 As with any publicly-offered securities, the Underwriters will represent their
17 own interests, and the Companies will represent their interests. As
18 discussed in detail in the testimonies of Public Staff witnesses Klein, Moore,
19 Schoenblum, Abramson, Maher and Sutherland, the interests of the
20 Underwriters and the Companies do not necessarily align with the interests
21 of ratepayers, so this lack of representation of ratepayer interests can affect
22 the pricing, the transaction documents and every aspect of the deal.

1 Nothing will occur without the hard work and collaborative efforts of all the
2 parties involved. The Companies, the Public Staff and the Commission can
3 work together, and they can create the balance necessary to manage
4 competition among Underwriters and investors.

5 Public Staff witness Schoenblum describes these best practices in more
6 detail.

7 Effective representation of the interests of ratepayers through Public Staff
8 supporting the Commission at every step through issuance of the bonds is
9 the first element. Decisions affecting ratepayers should be made in
10 consultation with an independent advisor with experience in this unique
11 segment of the capital markets and with a specific and direct fiduciary duty
12 to ratepayers.

13 The second element is the decision-making standard. This is critical. The
14 standard should be the best possible deal for ratepayers at the time of
15 pricing, the lowest possible cost of funds. Anything less, allows for less than
16 optimal results. Why? Very simply, without a lowest cost, best price
17 standard, "why bother?" There is little incentive for any additional effort and
18 hard work. The bonds can be priced quickly and move on.

19 But, the simple facts are that unless you negotiate hard on your behalf with
20 Wall Street, across the table from those sophisticated and large investors
21 with differing views, you will leave substantial amounts of money on the
22 table. Each side is looking out for its own economic interests. The
23 underwriters and investors want the best deal for themselves. One must

1 negotiate equally hard and be equally diligent to arrive at a fair transaction
2 that achieves the lowest cost to ratepayers and is fair value to the investor.
3 So, without a clear standard and a negotiating position that includes the
4 potential for the issuer and ratepayer representatives saying “no” when
5 evaluating offers, Underwriters and investors will have the negotiating
6 leverage to dictate a final cost to ratepayers. Remember, the best way to
7 lose control of the sale price of your house is to tell prospective buyers that
8 you must sell your house today because you really need the money now.
9 Pricing leverage will quickly shift.

10 The final element is for key transaction participants — the Companies,
11 Underwriters, and an independent financial advisor — to deliver to the
12 Commission written certifications, without material qualifications, confirming
13 that what they have done has led to the lowest cost of funds and the lowest
14 storm recovery charges consistent with market conditions at the time of
15 pricing. It is a basic business principle — “put it in writing.”

16 Any prudent person would want it in writing. For example, investors want
17 documentation before they give up their money. They do not rely solely on
18 oral representations before investing. With Sarbanes Oxley and a
19 heightened need to maintain public confidence in business, certifications
20 have become a part of normal business “best practices.”

21 This certification process has been employed successfully in Texas,
22 Florida, West Virginia, Louisiana and New Jersey. Many major

1 Underwriters have delivered these certificates on our transactions, along
2 with all eight utilities. North Carolina ratepayers deserve no less.

3 **Q. PLEASE LIST YOUR RECOMMENDATIONS TO THE**
4 **COMMISSION.**

5 A. I recommend that the Commission:

6 (1) incorporate into its Financing Order the “best practices” as
7 outlined in this testimony;

8 (2) require certifications from the Companies, the bookrunning
9 underwriter(s) and the Public Staff’s financial advisor that the
10 structuring, marketing and pricing of storm recovery bonds in fact
11 achieved the lowest storm recovery charges consistent with market
12 conditions at the time of pricing and the terms of the Financing Order;
13 and

14 (3) approve oversight by the Commission, the Public Staff and its
15 financial advisor through their participation in real-time through a
16 Bond Team on all matters related to the structuring, marketing, and
17 pricing of the storm-recovery bonds.

18 **Q. HOW DO YOU EXPECT THE TRANSACTION TO PROCEED?**

19 A. The Companies, their advisors, as well as the Commission, Public
20 Staff, and their advisors can work collaboratively and expeditiously to
21 complete this important transaction and establish this new financing
22 technique for the benefit of ratepayers and of the Companies.

- 1 Q. DOES THIS CONCLUDE YOUR TESTIMONY?
- 2 A. Yes, it does.