

**STATE OF NORTH CAROLINA
UTILITIES COMMISSION
RALEIGH**

DOCKET NO. E-7, SUB 1243
DOCKET NO. E-2, SUB 1262

BEFORE THE NORTH CAROLINA UTILITIES COMMISSION

In the Matter of	
Joint Petition of Duke Energy Carolinas,)
LLC and Duke Energy Progress, LLC)
for Issuance of Storm Recovery)
Financing Orders)
	POST-HEARING BRIEF

NOW COMES THE PUBLIC STAFF – North Carolina Utilities Commission (Public Staff), by and through its Executive Director, Christopher J. Ayers, and respectfully provides this Post-Hearing Brief pursuant to the North Carolina Utilities Commission’s (Commission) November 6, 2020 Order Scheduling Hearing, Requiring Filing of Testimony, and Establishing Discovery Deadlines in the above-captioned dockets.

SUMMARY

The Public Staff recommends that the Financing Orders require a process that enables the structuring, marketing, and pricing of the storm recovery bonds based on the “best practices” described in the testimony of the Public Staff witnesses (Best Practices). To that end, in response to proposals made by the Companies, and consistent with Best Practices, the Public Staff makes the following principal recommendations:

1. The Financing Orders should provide that (a) a Bond Team be established consisting of the Companies and their advisor, the Commission and

its financial advisor and legal counsel, and the Public Staff and its financial advisor; (b) designated representatives of the Companies, Commission, and Public Staff have equal decision-making authority on all aspects of structuring, marketing, and pricing of the proposed Storm Recovery Bonds and any SRB Securities; and (c) the Commission's designated Commissioner resolves any issue as to which the designated representative of the Companies and the designated representative of the Public Staff are unable to reach agreement involving the structure, marketing, and pricing of the bonds. Upon pricing of the bonds, the Bond Team's results and recommendations will be presented to the full Commission for consideration and final approval. The full Commission decides whether bonds comply with the statute and Financing Orders for final approval by deciding whether to issue a "stop order" preventing issuance of the storm recovery bonds. The Financing Orders should further provide that:

- a) The Bond Team include in the transaction documents all ratepayer protections found in the transaction documents in the Florida/DEF Transaction (as hereafter defined);
- b) The Bond Team select the underwriters and legal counsel for underwriters through a process mutually agreed upon by all members of the Bond Team; and
- c) The Companies' structuring advisor is not allowed to serve as sole bookrunning underwriter for the storm recovery bonds, but may allow such structuring advisor to participate in transaction as an

underwriter, if the modeling of the bond offering is independently determined.

2. In accordance with well-established precedent, the Financing Orders should allow for sufficient due diligence by the Commission and the Public Staff, including allowing their advisors to actively participate in the due diligence process, visibly and in advance in all aspects of structuring, marketing, and pricing the proposed storm recovery bonds. The Public Staff and Commission staff should verify important transaction information without limitations or exceptions.

3. To ensure ratepayers pay the lowest storm recovery charges possible, the Financing Orders should clarify that “consistent with market conditions” as referenced in N.C.G.S. § 62-172(b)(3)b.3. includes allowing underwriters to commit at the time of pricing to purchase all offered storm recovery bonds with their own financial capital, without regard to whether the underwriters at the time of pricing have orders from investors to purchase all (100%) of the offered storm recovery bonds. In other words, the “market” includes underwriters, and their capital.

4. So that the Commission has sufficient information upon which to make its decision whether to approve the issuance of the bonds, and consistent with Best Practices, the Financing Orders should require as a condition to issuing storm recovery bonds that the Companies, lead underwriters, and the Public Staff (through its financial advisor) each deliver a confirming certificate to the

Commission (Certification).¹ Each Certification should confirm, without material qualification, that the structuring, marketing, and pricing of storm recovery bonds has in fact resulted in the lowest storm recovery charges consistent with market conditions at the time the storm recovery bonds were priced and consistent with the terms of the Financing Order (Lowest Charge Standard).

BACKGROUND

Ratepayer-Backed Bonds are fundamentally different and involve differently-aligned interests from the Companies' corporate debt.

Ratepayer-Backed Bonds are inherently different from the type of bonds that the Companies have issued to-date. In traditional utility bond transactions, a utility has a significant economic incentive to achieve lowest costs due to the risk that some portion of its debt costs may be disallowed as unreasonable. When a traditional debt issuance is subject to the scrutiny of the rate regulator, including sufficiency of the utility's efforts to achieve the lowest reasonable cost of debt and resulting inclusion in rates, the utility has a clear incentive to achieve lowest cost bond issuances so that it can maximize its ability to earn the full allowed return for its shareholders. The utility knows that the Commission has full ongoing review of all costs in future rate cases and that recovery of some of a utility's debt costs from customers may be disallowed. Moreover, the existence of regulatory lag encourages a utility to limit costs in between general rate cases. These concepts

¹ Self-Certifications provided by the Companies are referred to in this brief as "Self-Certifications." DEC/DEP propose to attach a Certification as an Exhibit to the Companies' respective Issuance Advice Letters (IAL).

are part of the traditional regulatory ratemaking process and help ensure that the Lowest Charge Standard is achieved.

Ratepayer-Backed Bonds differ from traditional utility bonds in a number of material ways, including:

- Ratepayer-Backed Bonds are paid back directly by the ratepayers through a separate non-bypassable charge, and are not repaid from general revenues of the Companies, which could impact shareholder returns;
- Ratepayer-Backed Bonds are rated Aaa/AAA/AAA, higher than the Companies' bonds;
- Ratepayer-Backed Bonds are subject to an automatic, periodic true-up adjustment mechanism to ensure bondholders are always paid in full on or before the date when payments are legally due by redistributing any losses, write offs, or other shortfalls of any customers to all other ratepayers on a continual basis;
- Ratepayer-Backed Bonds are not included in corporate debt for the Commission's cost of capital rate-making purposes;
- Ratepayer-Backed Bonds are not subject to ongoing regulatory review by the Commission and are not at risk for future disallowance; and
- In the event of fundamental change in the electric utility industry, or significant financial events affecting individual ratepayers or the Companies, none of the above changes.

Public Staff witness Fichera further described the differences between traditional utility bonds and Ratepayer-Back Bonds as follows:

Traditional utility bonds are simple and straightforward. The structure, marketing, and pricing are streamlined because the utility is a frequent issuer, i.e., often in the market with a great deal of information readily available to investors. Offering documents often have been prepared in advance and are on file with the Securities and Exchange Commission. ... [t]he structure of a traditional utility bond is direct debt of the utility with the commission retaining all regulatory authority over the utility and all customer rates.²

...

[T]he structure of the bond is materially different, more complex than a traditional utility bond. The bondholder is a creditor of a special issuer but with a dedicated and specific charge on all ratepayers. None of the utility's creditors have a claim on those revenues even in a bankruptcy. The utility, after receiving the proceeds of the bond sale, in this case is merely acting as the "servicer" of the Ratepayer-Backed Bonds. This means they simply calculate, charge, bill and collect the revenue from ratepayers to repay the bonds on time.³

Thus, Ratepayer-Backed Bonds lack a number of the traditional ratemaking checks and balances that work to the benefit of ratepayers.

While a utility may seek to achieve the lowest cost Ratepayer-Backed Bonds in an effort to reduce the general financial burden on customers, the financial consequences to the utility's shareholders of issuing higher yielding bonds are lessened. Because issuance of the Ratepayer-Backed Bond will provide immediate cash to the utility, the utility is incented to issue bonds quickly to recover its costs. While this is not an inappropriate incentive, there is a real risk that speed

² Witness Fichera direct testimony, Tr. Vol. 3, p. 207.

³ Witness Fichera direct testimony, Tr. Vol. 3, p. 210. Companies' witness Atkins provides a similar description of the differences between traditional utility bonds and Ratepayer-Back Bonds in his direct testimony, Tr. Vol. 3, pp. 126-129.

sacrifices the ability to obtain the best deal in the marketplace, particularly when the party on the other side of the negotiating table has differently aligned interests.

Underwriters are on the other side of the negotiating table, with no fiduciary duty to act in the best interests of the utility or the ratepayers.⁴ Apart from the prospect of repeat business from the utility, there is no financial or other incentive for underwriters to structure, market, or price bonds in the best interests of ratepayers. Indeed, the underwriters' incentive is also to achieve the quickest sale with the least amount of time, no risk to their capital, and the highest possible fees for their services. The underwriting agreement is not a fee-for-service contract.⁵

In the middle are utility customers who are directly and irrevocably responsible for repaying the Ratepayer-Backed Bonds on a joint basis. This means that if some customers do not pay their assessed charges, those amounts are redistributed to all other ratepayers on a continuous and automatic basis until the bonds are repaid in full. The utility and underwriter have no compelling common interest that incents them to drive the hardest bargain for Ratepayer-Backed Bonds. One needs the bond proceeds, while the other needs to re-sell the bonds, and both are incented to move as quickly as possible in the market. However, as the evidentiary record shows, the presence of an active regulator and an active consumer advocate is necessary to fill the gap.⁶

⁴ Witness Maher direct testimony, Tr. Vol. 3, pp. 274-277.

⁵ Witness Fichera oral testimony, Tr. Vol. 3, pp. 418-419.

⁶ Fichera Figure 7, witness Fichera direct testimony, Tr. Vol. 3, p. 211 (corrected to change word "Utility" to "Utilities").

**Normal Incentives for “Lowest Cost” Absent
Traditional Checks and Balances Missing
Commission Must Forgo All Further Review**



The 2016 Florida/DEF Financing Order and subsequent transaction (Florida/DEF Transaction) included detailed and well-established Best Practices as identified by Public Staff witnesses that should serve as a model for this proceeding.

While the Companies and Public Staff support using the Florida/DEF Financing Order as a model (Florida/DEF Model) for the Commission’s Financing Orders in this proceeding, key aspects of the Florida/DEF Model remain missing from the Companies’ proposal, as depicted in the chart below:

Florida vs. North Carolina

DEF Model vs. DEC/DEP Proposal

Financing Order Requirements	DEF Model	DEC/DEP Proposal
<i>Bond Team with Ratepayer Interests Represented with Access to Independent Experienced Advisors</i>	X	?
<i>Sufficient Due Diligence by Ratepayer Representatives in Structuring, Marketing, and Pricing</i>	X	
<i>Definition of “Market Conditions” includes Underwriters, and their Capital</i>	X	
<i>Ratepayer Protections in All Transaction Documents</i>	X	
<i>Independent Certifications Required (Bookrunning Underwriters and Independent Financial Advisors)</i>	X	
<i>Only Self-Certifications – No Independent Certifications</i>		X

The securitization process has three main phases:⁷



1

Petition for Financing Order; Write Detailed Financing Order



2

Implementation of the Financing Order



3

Price Bonds Through Sale to Investors

⁷ Fichera Figure 2, witness Fichera direct testimony, Tr. Vol. 3, p. 204.

- **Phase One:** Petition from the utility, filing of testimony, initial due diligence, evidentiary hearing, and the writing and issuing of a detailed Financing Order.⁸
- **Phase Two:** Implementation of the Financing Order, in particular the formation of a Bond Team and the structuring, marketing, and initial pricing of the bonds.
- **Phase Three:** Final pricing of the bonds; delivery to the Commission of Certifications by the sponsoring utility and by independent parties; Commission decision whether or not to issue a stop order; and issuance of the bonds.

ISSUES THAT THE FINANCING ORDERS SHOULD RESOLVE

Many conditions proposed in the Companies' Joint Petition and associated testimony and exhibits are consistent with conditions also proposed by Public Staff.⁹ But there is not agreement on the following:

- **Bond Team** – The Public Staff seeks to participate as a joint-decision maker with the Companies and the Commission on the Bond Team, in order to assist the Commission and fulfill the Public Staff's role as statutory utility consumer advocate during structuring, marketing, and pricing of storm recovery bonds, prior to the Commission deciding whether to approve the transaction and impose those charges on

⁸ The Companies and Public Staff agree that the Commission should issue Financing Orders authorizing the issuance of storm recovery bonds, subject to conditions. But the Companies and Public Staff disagree on the conditions, including the degree of flexibility granted the Companies in connection with post-Financing Order structuring, marketing, and pricing of the storm recovery bonds. As of the date of this brief, this is the only remaining disputed item in Phase One of the process.

⁹ For example, on January 27, 2021, the Companies and the Public Staff filed an Agreement and Stipulation of Partial Settlement largely on accounting issues (2021 Stipulation).

customers.^{10 11} The Bond Team is a continuation of the Financing Order process. The Financing Orders should provide that (a) a Bond Team be established consisting of the Companies and their advisor, the Commission and its financial advisor and legal counsel, and the Public Staff and its financial advisor; (b) designated representatives of the Companies, Commission, and Public Staff have equal decision-making authority on all aspects of structuring, marketing, and pricing of the proposed Storm Recovery Bonds and any SRB Securities, including without limitation matters that could expose the Companies or the SPE issuer(s) to securities law liability or other potential liability; and (c) the Commission's designated Commissioner resolves any issue as to which the designated representative of the Companies and the designated representative of the Public Staff are unable to reach agreement involving the structure, marketing, and pricing of the bonds. Upon pricing of the bonds, the Bond Team's results and recommendations will be presented to the full Commission for consideration and final approval. The full Commission decides whether bonds comply with the statute and Financing Orders for final approval by deciding whether to issue a "stop order" preventing issuance of the storm recovery bonds. The Commission's Financing Orders should also resolve whether the Bond

¹⁰ In Florida, the FPSC staff routinely take on some of the roles of the Public Staff in North Carolina, namely, investigation, filing of testimony, and sending and responding to data requests from utilities. Fichera oral testimony, Tr. Vol. 4, pp. 27-29.

¹¹ Storm recovery bonds are Ratepayer-Backed Bonds, and are referred to herein and in filings in these dockets as "bonds," "Storm Recovery Bonds," and "SRBs." SRBs can also encompass SRB-related securities, referred to as "SRB Securities."

Team is required to include ratepayer protections found in the Florida/DEF Transaction documents in this transaction's documents; whether the Bond Team selects the underwriters and legal counsel for underwriters through a process mutually agreed upon by all members of the Bond Team.

- **Sufficient Due Diligence** – Commission and the Public Staff, through their advisors should perform due diligence, visibly and in advance, and not be limited by exceptions that would all but prevent verifying important transaction information.
- **Market Conditions** – The Public Staff recommends that the Commission find that “consistent with market conditions” as referenced in N.C.G.S. § 62-172(b)(3)b.3. includes allowing underwriters to have a stake in the transaction at the time of pricing to achieve the Lowest Charge Standard, as in the Florida/DEF Transaction. The “market” includes underwriters and their capital.
- **Independent Certifications** – Consistent with well-established precedent, the Commission should require confirming Certifications that the lowest storm recovery bond charges have in fact been achieved. The Certification should be required not just from the Companies (Self-Certifications), but also from bookrunning underwriters and the financial advisors to the Commission and Public Staff.

1. A pre-bond issuance process should be required to include a Bond Team to oversee the structuring, marketing, and pricing of storm recovery bonds prior to final Commission approval.

The Companies' Joint Petition and direct testimony proposed a structure that would make the Companies the sole decision-maker on all aspects of structuring, marketing, and pricing the storm recovery bonds throughout Phase 2, unconstrained by any Bond Team. However, in rebuttal testimony, witness Heath stated that the Companies would support a Bond Team comprised of the Companies, their advisor and counsel, and a designated Commissioner or member of Commission staff, including any independent consultants or counsel hired by the Commission.

Witness Heath also stated that the Companies would "not object" to a Bond Team "consistent with the bond team approach used in DEF's transaction."¹² However, witness Heath did not fully convey how the DEF bond team approach operated.

The "bond team approach used in DEF's transaction" called for the formation of a Bond Team to oversee post-financing order / pre-bond issuance activities in a cooperative and collaborative process in furtherance of the structuring, marketing, and pricing of the bonds that result in the securitization charges. A designated representative of DEF was one of two joint decision-makers

¹² Witness Heath rebuttal testimony, Tr. Vol. 1, pp. 103-104.

with respect to most decisions, subject to a final “up-or-down” decision by the full FPSC after pricing as to whether to issue a “stop order.”

Importantly, the Florida/DEF Financing Order allowed FPSC staff to participate as a joint decision-maker to be a ratepayer representative that submitted direct testimony, served data requests on DEF, responded to data requests from DEF, and was a participant in the FPSC proceeding without need for discretionary leave to be granted “party” status by the FPSC. If the two joint decision-makers could not agree, a designated FPSC commissioner was authorized to break the deadlock during the process, which was prior to presenting the final results to the full Commission for consideration and final approval.¹³

A. The Bond Team should consist of representatives of the Companies, Commission, and Public Staff.

Reflecting the fundamental nature of this proceeding, the Bond Team should be comprised of three main participants (with their staffs and advisors):

- Companies – representing shareholder interests;
- Public Staff – representing ratepayer interests; and

¹³ Klein Exhibit 2, Tr. Official Exhibits Vol. 2. See Finding of Fact 50: “This Commission should designate one Commissioner to resolve any issue as to which the DEF and Commission staff joint decision makers are unable to reach agreement. Any such matter should be presented by the DEF and Commission staff joint decision makers by email or in other writing. The designated Commissioner should announce his or her decision on the matter presented to the DEF and Commission staff joint decision makers by email or other writing as soon as reasonably possible. The parties to this proceeding agree that the decision of the designated Commissioner should be final and not subject to review by this Commission.”

- Commission – balancing shareholder and ratepayer interests, resolving areas of disagreement, and serving as the ultimate “go / no-go” decision-maker.

The Public Staff strongly encourages the Commission to designate a representative to participate as a decision-making member of the Bond Team prior to the full Commission’s consideration of the Bond Team’s efforts. The Public Staff further encourages the Commission to retain a financial advisor to assist it as a member of the Bond Team during the structuring, marketing, and underwriting pricing of the bonds and the Certification process. The Commission representatives’ active participation will further ensure that the end-result of the structuring, marketing, and pricing underwriting process achieves the maximum benefit for ratepayers.

The Public Staff also should be a decision-making member of the Bond Team to further advocate customer interests and leverage the expertise of its experts to ensure the underwriting process achieves the maximum benefit for ratepayers. During the hearing, the Companies voiced support for allowing the Public Staff to participate in the Bond Team, albeit without decision-making authority and with greatly limited due diligence abilities. Witness Heath went so far as to state that “the Companies are strongly opposed to the recommendation that an ‘intervening party,’ even the Public Staff or its Consultant be given a joint

decision-making role in the transaction.”¹⁴ The Companies’ arguments lack substance.

The Public Staff is well-positioned to serve as a member of the Bond Team in a decision-making capacity and would complement, rather than replace, the role of the Commission. The Public Staff has undertaken a thorough investigation of the Companies’ Joint Petition, including extensive discovery. The Public Staff engaged Saber Partners as expert financial advisors to assist in the investigation and present evidence to the Commission. Through its experts, the Public Staff has an intimate understanding of the variables, constraints, competing interests, and pressures that will arise in the underwriting associated with this particular transaction.

The Public Staff also notes that: (i) Saber Partners has been involved in 13 prior Ratepayer-Backed Bond transactions for \$9.2 billion in five states; (ii) this will be the first Ratepayer-Backed Bond transaction for the Companies, the Commission, and the Public Staff; and (iii) Saber Partners played a major role in the only prior Ratepayer-Backed Bond transaction for any affiliate of the Companies, the nuclear asset-recovery bonds issued in 2016 for Duke Energy Florida, LLC.

The Public Staff is unable to identify any downside to its participation as a decision-making member of the Bond Team other than the arguments related to potential disagreements within the Bond Team. This concern is easily resolved. If

¹⁴ Witness Heath rebuttal testimony, Tr. Vol. 1, p. 81.

the Companies and Public Staff cannot agree on any matter related to the structuring, marketing, or pricing of storm recovery bonds, any deadlock could be resolved by the Commission representative or designated Commissioner, subject to the ultimate “go / no-go” decision of the full Commission. This is similar to the procedure embedded in the Florida/DEF Financing Order.¹⁵ If the Commission does not participate as a decision-making member of the Bond Team, the Commission can still designate a Commissioner for the limited purpose of resolving any issues to avoid any unnecessary delays.

B. If the Commission does not adopt the Public Staff’s recommendation regarding the composition of the Bond Team, it is imperative that either the Commission representatives or the Public Staff is included.

In the event the Commission chooses not to participate as a decision-making member of the Bond Team, it is critical that the Commission authorize the Public Staff to participate in the Bond Team in a decision-making capacity and without due diligence limitations. Similarly, if the Commission determines that the Public Staff should not possess decision-making authority as a member of the Bond Team, it is imperative that Commission designate a representative to participate as a member of the Bond Team with joint decision-making capacity and leverage a financial consultant to undertake robust due diligence. Without Commission or Public Staff involvement, there will be no ratepayer representation

¹⁵ Klein Exhibit 2, Tr. Official Exhibits Vol. 2.

with decision-making authority during the underwriting and Certification process, and thus no external check to ensure lowest cost pricing is championed. The Public Staff's participation along with Commission representatives is ideal, but the Commission's participation in the absence of the Public Staff is an absolute necessity. To avoid any doubt, the Public Staff stands ready, along with its financial consultant, to assist the Commission consistent with its obligations under N.C.G.S. § 62-15, regardless of whether the Commission grants it decision-making authority.

While arguing that the Commission can sufficiently protect ratepayer interests without the Public Staff,¹⁶ the Companies nonetheless suggest that involving the ratepayer advocate's advisor, Saber Partners, would somehow be a conflict of interest. The Public Staff strongly disagrees that any such conflict would exist after the issuance of the Financing Orders. Once the Commission has issued the Financing Orders, the balancing of utility and ratepayer interests is concluded, and the interests of the Commission and Public Staff are aligned to achieve the lowest possible cost for ratepayers through the structuring, marketing, and pricing process. Further, the Public Staff has no objection to the Commission's utilization or engagement of Saber Partners during the structuring, marketing, and pricing or

¹⁶ It is important to note that the Public Staff does not dispute that the Commission itself can thoroughly evaluate ratepayer interests as it routinely balances ratepayer interests against shareholder interests as part of the Commission's regular decision-making. The Public Staff merely seeks to exercise its role as defined in N.C.G.S. § 62-15 through the entirety of the securitization process and believes a second advocate in the room can only further ensure the best outcome for ratepayers.

Certification processes, either jointly with the Public Staff or exclusively by the Commission.

2. Robust due diligence is required to ensure maximum ratepayer benefits.

The financial advisors to the Public Staff and the Commission should be allowed to be active participants, visibly and in advance, in all aspects of structuring, marketing, and pricing the storm recovery bonds to ensure maximum ratepayer benefits. This is a key rationale for enabling legislation in North Carolina and for this first storm recovery bond issuance. This is also consistent with the Florida/DEF Financing Order, which states:

This Commission's designated staff and financial advisor will be visibly involved, in advance, in all aspects of the structuring, marketing, and pricing of the nuclear asset-recovery bonds.

* * *

To ensure that the statutory cost objectives and the lowest overall cost standard are met and that these procedures are followed, this Commission – as represented at various stages either jointly or separately by designated Commission personnel, with support from this Commission's financial advisor and this Commission's outside legal counsel, as the designated Commission personnel deem appropriate – will participate visibly and in advance in the structuring, marketing, and pricing of the nuclear asset-recovery bonds in accordance with the standards, procedures and conditions established in this Financing Order.¹⁷

¹⁷ Klein Exhibit 2, Tr. Official Exhibits Vol. 2, Florida/DEF Financing Order. See p. 10. See also Finding of Fact 44: "This Commission's designated staff and financial advisor should be visibly involved, in advance, in all aspects of the structuring, marketing, and pricing of the nuclear asset-recovery bonds." and Ordering Paragraph 40: "ORDERED that this Commission's designated staff and financial advisor shall be visibly involved, in advance, in all aspects of the structuring, marketing, and pricing of the nuclear asset-recovery bonds."

This also is consistent with the approach mandated by the Public Utility Commission of Texas (PUCT) in connection with its earliest Ratepayer-Backed Bond issuances.

The Companies seek to limit ample, sufficient, and regulatory-compliant due diligence by the Public Staff and its advisor by proposing a “securities law” exception that would inhibit legitimate investigation. The Companies assert that they will have primary securities law liability with respect to the transaction, while the State of North Carolina and any intervenor will “have no liability and therefore should not be in position of any joint decision-making authority.”¹⁸ The Companies use this assertion to propose that only a designated representative of the Companies and a designated representative of the Commission staff be joint decision-makers in all aspects of structuring, marketing, and pricing of the proposed storm recovery bonds, except for matters that, in the sole view of the Companies, would expose the Companies or the SPE issuer(s) to securities law or other potential liability – as to which a designated representative of the Companies would be the sole decision-maker.

The Companies’ position is not credibly supported by the record. There is nothing in the record indicating that securities law violations have occurred in connection with any of the more than 60 prior Ratepayer-Backed Bond

¹⁸ Witness Heath rebuttal testimony, Tr. Vol. 1, p. 95: “[P]rimary securities law liability and contractual liability rests with the public utility and its assignee and not with the State of North Carolina or with any intervenor to the proceeding [Public Staff]. Unlike the Companies, the intervenors have no liability and therefore should not be in position of any joint decision-making authority.”

transactions, 13 of which include Saber Partners. Witness Heath acknowledged that no violations occurred or were alleged to have occurred in the Florida/DEF Transaction by DEF, the FPSC, or the FPSC's financial advisor, Saber Partners.¹⁹ Finally, in cross-examination, witness Atkins testified that no violations occurred or were alleged to have occurred in any of the twenty-five Ratepayer-Backed Bond transactions in which he has participated.²⁰

The Companies should not be allowed to limit regulatory-compliant due diligence or inhibit legitimate investigation absent overwhelmingly compelling circumstances, none of which exist in the record.

3. The Companies should not be allowed to define “Market Conditions” in a way that could increase costs to ratepayers.

As with almost any commercial transaction, marketing Ratepayer-Backed Bonds to the widest audience helps achieve the optimal outcome. Marketing is a key aspect of two areas of disagreement between the parties, one in Phase 2 and the other (which is a result of the first) in Phase 3:

- 1) The statutorily-indicated “market conditions”²¹ allows the underwriters to accept a stake (use their capital) in the transaction in

¹⁹ Witness Heath oral testimony, Tr. Vol. 1, p. 143.

²⁰ Witness Atkins direct testimony, Tr. Vol. 3, pp. 126-129.

²¹ N.C.G.S. § 62-172.(b)(3)b.3. requires that the Financing Order – in authorizing and setting forth expectations for the process that is to follow – include 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.” [Emphasis added.]

making a market for the bonds, thereby allowing the true lowest (lowest in fact) storm recovery charges for ratepayers.

- 2) The standard of Certifications, in particular for the Certifications from independent third parties, should also be true lowest (lowest in fact) storm recovery charges for ratepayers.

Witness Heath's testimony rightly indicates that the price of the storm recovery bonds will not be known at the time of the Financing Orders. The requirement in N.C.G.S. § 62-172(b)(3)b.3 is that the Financing Orders – in authorizing and setting forth expectations for the process that is to follow – include 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. [Emphasis added.]

This statutory provision is clearly a going-in requirement for the process, not an outcomes-based requirement. In other words, N.C.G.S. § 62-172(b)(3)b.3 sets forth a standard that must be met to move from Phase 1 to Phase 2. During the evidentiary hearing, witness Heath acknowledged that it would be appropriate for the Financing Orders to rely on N.C.G.S. § 62-172(b)(3)b.12 to require an additional true lowest cost in fact outcome standard.²²

²² Witness Heath oral testimony, Tr. Vol. 4, page 193:

“Q. Duke's commitment and your testimony in both live and prefiled is that you intend to certify to the lowest cost consistent with market conditions at the time the bonds are issued; am I correct about that?”

In a negotiated public offering, all bonds are actually sold in a two-step process. The bonds are initially purchased by the underwriters, and immediately thereafter, the underwriters “re-offer” the bonds to the final purchasers.²³ The question is whether the underwriters must have orders from prospective purchasers for 100% of the bonds before the initial contract for sale to underwriters can be executed.

Like N.C.G.S. § 62-172(b)(3)b.3, Section 39.301 of the State of Texas Public Utility Regulatory Act requires that “the structuring and pricing of the transition bonds result in the lowest transition bond charges **consistent with market conditions** and the terms of the financing order.”²⁴ [Emphasis added.] Fichera Exhibit 4 shows that those Ratepayer-Backed Bonds issued for AEP / Texas Central were offered in five tranches, including \$437 million of Tranche 4

A. That is correct.

Q. Okay. And so market conditions would be baked into that certification at that point, right?

A. Yes.

Q. ... So you're gonna certify to lowest costs, correct?

A. That is correct, yes.

Q. Okay. At the time of issuance, is there a more stringent standard? I mean, is there something lower than lowest?

A. Not to my knowledge, no. The remaining issue, however, is how to define ‘market conditions at the time of pricing.’”

²³ In the public offering, there are actually two sales:

- First, underwriters are the initial purchasers of the bonds at a negotiated discount to the value of the bonds. The interest rate and terms of the bonds are also negotiated.
- Second, the underwriter reoffers the bonds to investors.

During this process and during the negotiation, the underwriter tests the market for the bonds at different interest rates. At the time of pricing - when the underwriter agrees to buy all of the bonds - the underwriter may or may not have orders for all of the bonds. The Companies wish to require that the underwriter have 100% orders and not use any of its own capital even if that means the interest rate is higher on the bonds. The Public Staff recommends that the Financing Order permit the underwriters to use their own capital in making the market for the bonds at the lowest cost to the ratepayer. The Bond Team must have the freedom to negotiate with underwriters, including to allow the underwriters to use their own capital to achieve the lowest cost to the ratepayer.

²⁴ See Klein Exhibit 1, Tr. Official Exhibits Vol. 2.

bonds.²⁵ Fichera Exhibit 4 further shows that at the time of pricing, the underwriters had orders from investors for only \$420 million of the Tranche 4 bonds. The interest rate was not increased on all Tranche 4 bonds simply to get orders for this last \$17 million in bonds. During the evidentiary hearing, witness Fichera testified that this did not prevent the underwriters from executing an underwriting agreement committing to purchase all \$1.74 billion of the publicly offered bonds, nor did this prevent the outside legal counsel for the issuer from delivering the customary opinion that the bonds had been validly issued under the State of Texas Public Utility Regulatory Act.

The Companies' approach potentially leaves money on the table for North Carolina ratepayers, and could force them to pay higher storm recovery charges than necessary. Public Staff witness Brian Maher, the former Assistant Treasurer and 30-year veteran of Exxon Mobil Corporation for external finance and a Senior Advisor to Saber Partners, testified most succinctly on this issue of "market conditions" as follows:

...I listened to Mr. Heath's testimony and he talks about clearly the statute talks about consistent with market conditions at the time the bonds are priced. Well, you know, I have a lot of respect for him and I have a lot of respect for Duke, but I don't define market conditions the same way that he does.

Underwriters, in my view, are part of the market, as exemplified by how I just described we used to issue the bonds. So, for me -- and this goes back to that interesting conversation between Mr. Creech and Mr. Heath, and the Commissioners got involved as well, as to whether underwriters would be expected to own parts of the bonds. Now, typically -- typically not, but when they bid, I can tell you the winner would probably more often than not wind up holding some of those bonds, because they would bid at such a tight price that they

²⁵ Fichera Exhibit 4, Tr. Official Exhibits Vol. 2.

would own some until they could sell them. They would hedge them against the Treasury so they didn't lose large amounts or gain large amounts.

But the point is that my idea of an aggressive marketing is not to wait until the underwriter has all the investors ready and then say, okay, that's the best we could do. In my -- in the 95/5 example that Mr. Creech gave, if we got there, we would say to the underwriter -- if we were doing it, if it were this kind of a deal, we would say, "Okay, it's time for you to step up. You're making \$4- or \$5 million on this deal, and it's time to step up and take the last 5, because we don't want to pay more for the other 95."

It's a difference in approach as to how you define what market conditions you are and how aggressive you are going to be with underwriters. And we did do that on a couple of occasions where we had more specialized transactions which involved negotiating -- actual negotiated deals.²⁶

The crux of the matter is whether North Carolina ratepayers through the Bond Team can negotiate with underwriters and allow underwriters to have a stake in the transaction by putting their own capital at risk, helping ensure a lowest cost to the ratepayer outcome for the Companies' ratepayers similar to the outcome achieved for ratepayers in the Florida/DEF Transaction and for Texas ratepayers in the 2006 AEP / Texas Central transaction. The Financing Order should make clear that the Companies' new interpretation for North Carolina is not allowed; rather, that the definition of "market" -- as always and as presumed -- still includes underwriters and their capital, so as not to potentially require rates to be increased by virtue of not allowing underwriters to use their capital in purchasing the bonds.

²⁶ Witness Maher oral testimony, Tr. Vol. 3, pp. 407-409.

4. Independent Confirming Certifications should be required. Self-Certifications by themselves do not provide sufficiently reliable information upon which the Commission can decide whether or not to issue a stop order.

The Companies have volunteered to deliver Self-Certifications as part of their Issuance Advice Letters. The Companies do not object to additional Certifications being requested from others, so long as additional Certifications are not required as a condition to issuing of storm recovery bonds.

In accordance with best practices and well-established precedent, bookrunning underwriters and an independent financial advisor should also be required to deliver Certifications or opinions that the lowest cost standard has in fact been achieved. Independent Certifications are needed to protect and best serve the ratepayers, and to reassure the Commission in this instance where the Commission will not have the benefit of traditional ongoing regulatory oversight.

The Public Staff proposes the following mechanics for Certifications:

- Companies submit their Issuance Advice Letters (including lowest cost Certifications) no later than 5:00 pm Eastern time one business day after pricing.
- Bookrunning underwriters and the independent financial advisor deliver their lowest cost Certifications / opinions no later than 5:00 pm Eastern time on the second business day after pricing.
- The Commission notices a meeting for the morning of the third business day after pricing for the purpose of considering the

Issuance Advice Letter and confirming Certifications and whether to issue a “stop order” by noon Eastern time, if necessary. The Commission would issue a “stop order” only if:

- the Commission determines that the Issuance Advice Letters and all required Certifications have not been delivered without material qualification; or
- the transaction otherwise does not comply with the Financing Orders and other applicable law.

In Ratepayer-Backed Bond transactions, utilities can be required to certify to the Commission that – in the utility’s evaluation of itself – the utility has done a good job, perhaps even undertaken its best efforts. While helpful, such “Self-Certifications” are not sufficient by themselves; independent Certifications should also be required of bookrunning underwriters and from independent financial advisors.²⁷

In the Florida/DEF Transaction, three non-utility Certifications were required by the FPSC: one from each of the two bookrunning underwriters and one from the FPSC’s financial advisor. A limited Self-Certification from DEF was provided to the FPSC as part of DEF’s Issuance Advice Letter. Unlike the more robust Certifications provided by the bookrunning underwriters and the FPSC’s financial advisor, DEF’s Self-Certification did not address whether “marketing” of the bonds resulted in the lowest securitization charge consistent with market conditions at the

²⁷ Witness Moore direct testimony, Tr. Vol. 3, p. 380. See also, Summary of witness Abramson highlighting regulatory risk and impact on investors, Tr. Vol. 4, pp. 141-144.

time of pricing. The Companies nonetheless suggest that no independent Certifications be required by the Commission's Financing Order.

In North Carolina, the Companies have offered to provide a Self-Certification, allegedly to a higher standard than in the Florida/DEF Transaction. The Companies suggest that such a higher-level Certification should reassure the Commission so that it not require independent confirming Certifications. The Public Staff rejects such an approach as defying 1) market realities of Companies' shareholder interests and 2) the Florida/DEF Model where, according to witness Heath's testimony, three non-DEF confirming Certifications as to the lowest cost and requirements of the Florida/DEF Financing Order were provided to the full Commission for their consideration. The transcript of the open hearing to consider whether to issue a stop order in Florida is contained in the record of this case.

CONCLUSION

The legislature authorized securitization of storm costs in 2019 in an effort to reduce the financial burden that major storms continue to place on utility customers. As this is a case of first impression for the Commission, the Public Staff has proposed robust protections to ensure that customers receive the maximum benefit associated with the issuance of storm recovery bonds. The Public Staff's recommendations draw from the vast experience of its financial consultants, who were instrumental in the development of the Florida/DEF Model and the successful issuance of Ratepayer-Backed Bonds in that state.

The constitution of the Bond Team will play a key role in determining whether ratepayers receive the benefit of lowest cost Ratepayer-Backed Bonds. The strongest Bond Team would include the Commission, Public Staff, and Companies as members with decision-making authority along with their respective experts advising throughout the underwriting and Certification process. At a minimum, it is critical that the Bond Team includes either a Commission representative or Public Staff representative as a decision-making member with authorization to conduct robust due diligence throughout the remainder of the proceeding with access to and use of independent, experienced financial expertise in Ratepayer-Backed Bond transactions.

Respectfully submitted this, the 18th day February, 2021.

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CERTIFICATE OF SERVICE

I certify that I have served a copy of the foregoing Post-Hearing Brief on all parties of record in accordance with Commission Rule R1-39, by United States mail, postage prepaid, first class; by hand delivery; or by means of facsimile or electronic delivery upon agreement of the receiving party.

This the 18th day of February, 2021.

Electronically submitted
/s/ William E. H. Creech