

**TESTIMONY OF CALVIN C. CRAIG
ON BEHALF OF THE PUBLIC STAFF
NORTH CAROLINA UTILITIES COMMISSION**

December 21, 2020

1 **Q. PLEASE STATE YOUR NAME, POSITION, AND BUSINESS**
2 **ADDRESS FOR THE RECORD.**

3 A. My name is Calvin C Craig, III. I am a Financial Analyst in the
4 Economic Research Division of the Public Staff of the North
5 Carolina Utilities Commission (Public Staff), representing the using
6 and consuming public. My business address is 430 North Salisbury
7 Street, Raleigh, North Carolina 27603.

8 **Q. PLEASE OUTLINE YOUR EDUCATIONAL BACKGROUND AND**
9 **RELEVANT EMPLOYMENT EXPERIENCE.**

10 A. I received a Bachelor of Science degree in Industrial Relations from
11 the University of North Carolina at Chapel Hill in 1985, an MBA
12 degree from East Carolina University in 1993, and a Juris Doctor
13 degree from North Carolina Central University in 2006. In 2006 I
14 was admitted to practice law in North Carolina. Since joining the
15 Public Staff in November 1995, I have been involved with natural
16 gas expansion projects, have conducted rate of return studies, filed
17 affidavits and testimony assessing financial viability and a fair rate

1 of return in numerous water, wastewater, wind and solar utility rate
2 cases.

3 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS**
4 **PROCEEDING?**

5 A. The purpose of my testimony in this proceeding is to discuss the
6 impact and consequences of storm recovery bond financing on
7 ratepayers in North Carolina. I have examined the details of the
8 storm securitization bonds being proposed by Duke Energy
9 Corporation, LLC (DEC) and Duke Energy Progress, LLC (DEP),
10 (collectively as Companies). I will focus my discussion on several
11 issues that I believe are of concern to ratepayers including:
12 maximizing benefits to ratepayers, the appropriate term for these
13 storm recovery bonds, the appropriate cost of capital and discount
14 rate, and the need for the subject storm securitization bonds to
15 obtain an AAA bond rating,

16 **Q. HOW IS YOUR TESTIMONY STRUCTURED?**

- 17 A. My testimony is presented in the following four sections:
- 18 I. Maximization of Ratepayer Benefits
 - 19 II. The Appropriate Term for These Storm Recovery Bonds
 - 20 III. Discount Rate and Cost of Capital
 - 21 IV. The Importance of the Bonds Being Rated AAA

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I. MAXIMIZATION OF RATEPAYER BENEFITS

Q. WHY IS IT IMPORTANT THAT THE PROPOSED STORM RECOVERY BONDS BE STRUCTURED TO MAXIMIZE RATEPAYER BENEFITS?

A. N.C.G.S. § 62-172 requires the proposed storm recovery bonds be just and reasonable and in the public interest. N.C.G.S. § 62-172(b) 3b. 2. requires that the financing order include a finding that the issuance of storm recovery bonds and the imposition and collection of a storm recovery charge are expected to provide quantifiable benefits to customers as compared to the costs that would have been incurred absent the issuance of storm recovery bonds. These statutes require the maximization of benefits to the ratepayers. By attempting to achieve the lowest cost possible throughout all stages of structuring, marketing and pricing the proposed bonds, benefits to the ratepayers may be maximized. This maximization is possible if the bonds achieve an AAA rating because they can potentially be offered at the lowest interest rate to investors and the lowest cost to the ratepayers.

In her Exhibit 5 for both DEC and DEP, Companies witness Abernathy shows the potential savings that can be realized by ratepayers for both Companies by issuing the proposed storm recovery bonds. Her analysis in Exhibit 5 for DEC indicates that ratepayers could save up to \$58 million by using the proposed

1 bonds to pay for storm clean-up expenses, which is a savings of
2 approximately 32.2% over using the customary method of paying
3 for these expenses. Her analysis of using the storm recovery bonds
4 in Exhibit 5 for DEP shows that DEP ratepayers could save up to
5 \$199 million by using the proposed bonds to pay for storm clean-up
6 expenses, which is a savings of approximately 33.2% over the
7 customary method of paying for these expenses. The potential
8 savings is significant for ratepayers by using this alternative as
9 compared to the traditional method of paying for storm damage.

10 **II. THE APPROPRIATE TERM FOR THESE STORM**
11 **RECOVERY BONDS**

12 **Q. WHAT IS THE APPROPRIATE TERM OF THESE STORM**
13 **RECOVERY BONDS?**

14 A. The appropriate term bond maturity for the storm recovery bonds is
15 an issue that must consider the best interests of the ratepayers.
16 The Companies propose the use of a fifteen-year scheduled term
17 for the recovery of the storm costs through storm recovery bonds.
18 In Companies witness Heath's testimony, he states that DEC and
19 DEP prefer a 15-year amortization period for the bonds because it,
20 "strikes the right balance between the length of the recovery period
21 and the length and level of the recovery charge."

22 Public Staff witness Sutherland advocates for a longer amortization
23 period because the longer the amortization period, the higher the

1 level of net present value savings to the ratepayer and accordingly,
2 the greater the benefit to the ratepayer. Since a longer amortization
3 period does not penalize the utility but does benefit the ratepayer,
4 an amortization period longer than fifteen years strikes a more
5 appropriate balance. Witness Southerland supports his statement
6 by noting that witness Abernathy argues against a term beyond 15
7 years because she appears to believe that major storms will occur
8 more frequently in the future and that extending their term beyond
9 15 years would result in aggregating charges from new storms
10 before all the associated charges from previous storms were paid.

11 Witness Sutherland explains why a longer maturity would be more
12 beneficial to the ratepayers by noting that while utility assets are
13 generally depreciated over 40 years, taking the weighted average
14 of 15 years for the portion of bonds that finance current expenses,
15 and 40 years for the portion of bonds that finance capital assets,
16 the maturity would be 18 years rather than 15 years. Witness
17 Sutherland also notes that increasing the term of the bonds by
18 three years increases the net present value of the savings on the
19 bonds by roughly \$40 million for DEC and DEP ratepayers
20 combined. He also notes that interest rates are currently near
21 historically low levels and that extending the maturity of the bonds
22 allows both the Companies and the ratepayers to reap the benefits

1 of these low rates for a longer period. The Public Staff supports the
2 up to 20-year storm security bond term.

3 **III. COST OF CAPITAL AND DISCOUNT RATE**

4 **Q. WHAT IS YOUR OPINION OF THE VALIDITY OF THE DISCOUNT**
5 **RATE AND COST OF CAPITAL USED IN THE COMPANIES'**
6 **PROPOSAL TO USE STORM RECOVERY BONDS?**

7 A. My examination of the proposed structure of the bonds indicates
8 that both the appropriate discount rate and cost of capital were
9 used in the proposal by both DEC and DEP in the scenario
10 analyses performed by the Companies. As mentioned in Public
11 Staff witness Sutherland's testimony, there are a couple of sources
12 of the potential savings to be realized. The first savings results from
13 the interest rate differential between that of the customary utility
14 bonds and the higher rated storm recovery bonds. An additional
15 saving results from the fact that while traditional utility bonds have
16 to be offset by common equity in order to preserve the capital
17 structure of a utility company, there is no similar need for the
18 securitized utility bonds to be offset with the company's common
19 equity and the associated state and federal income taxes. Avoiding
20 the high cost of equity and taxes could account for as much as two
21 thirds of the total savings.

22 In her testimony, Companies witness Abernathy stated that she
23 used the stipulated, weighted average, net of tax, cost of capital for

1 both Companies as stipulated in their most recent rate cases.
2 These rates have not been approved by the Commission as of yet
3 but she believes they likely will be approved by the Commission
4 since they are the result of a joint stipulation between the Public
5 Staff and DEC and DEP. Witness Abernathy uses the stipulated rate
6 from Docket No. E-7, Sub 1214 for DEC, which is 6.56% and the
7 stipulated rate from Docket No. E-2, Sub 1219 for DEP, which is
8 6.48% in her net present value analysis to quantify the savings
9 benefit to ratepayers by issuing the proposed storm recovery
10 bonds. As previously stated, both of these rates are after-tax rates.
11 Witness Abernathy uses the pre-tax weighted average cost of
12 capital for DEC and DEP, 8.6% and 8.4%, respectively, to calculate
13 the return on accumulated deferred income taxes. My analysis
14 indicated that these are the appropriate rates to be used in her
15 analysis when assessing the potential savings to be realized by the
16 ratepayers.

17 In evaluating the appropriate cost of capital, it is important to point
18 out the fact that just as a utility company has a cost of capital, in
19 effect so does a ratepayer. Ratepayers reflect the spectrum of the
20 levels of household income that are present in a utilities' customer
21 base. There are households with significant assets and high
22 incomes that can typically obtain capital at an interest rate close to
23 or at the prime interest rate, and there are low income households

1 that may have few or no assets that have a much higher debt cost.
2 The storm recovery bonds are projected to be priced below a 2%
3 interest rate, which is likely substantially less than what many low-
4 income households in North Carolina pay for debt. This lower
5 interest rate should benefit ratepayers because few if any
6 ratepayers could borrow funds at an interest rate below 2%. As a
7 result, the lower cost of the securitized bonds benefits virtually all
8 ratepayers in general and ratepayers with low-income households
9 in particular. At a time when the economies of the state of North
10 Carolina and the United States are being negatively impacted by
11 the effects of COVID-19, the ability to pay for storm costs at an
12 interest rate less than 2% is a great benefit to all involved.

13 **IV. THE IMPORTANCE OF THE BOND BEING RATED AAA**

14 **Q. WHY IS IT IMPORTANT THAT THE PROPOSED STORM**
15 **RECOVERY BONDS OBTAIN AN AAA BOND RATING?**

16 A. As I stated above, the proposed bonds are required to be
17 structured to provide storm recovery at a lower cost to consumers
18 than they would pay under the traditional method of paying for
19 storm recovery costs. AAA is the highest rating that the bond rating
20 agencies assign to bonds and accordingly issuing AAA rated bonds
21 provides the bond issuer with the opportunity to obtain the lowest
22 cost payments on the bonds. The higher the storm recovery bond
23 rating, the lower the cost to the ratepayers. An AAA rating indicates

1 to investors that the bonds have less risk than non AAA rated
2 bonds, and as a result investors typically require a lower interest
3 rate when purchasing these bonds. By obtaining a AAA rating, the
4 bonds can potentially be offered to investors at or near the lowest
5 possible interest rate and also at or near the lowest cost to the
6 ratepayers. This use of the lowest cost only increases the benefit of
7 the AAA bond rating to the ratepayer, because it provides the
8 opportunity to make the most efficient use of the assets as
9 collateral for the bonds.

10 However, simply obtaining a rating of AAA does not guarantee that
11 the most efficient use of the collateral securing the bonds has been
12 realized due the complex nature of bonds in general and storm
13 recovery bonds in particular. Additionally, all AAA rated bonds are
14 not the same nor do they possess the same level of risk. Typically,
15 securitized utility bonds are considered less risky by investors and
16 thus more attractive than regular utility bonds because they are
17 issued by a bankruptcy remote special purpose entity (SPE) which
18 make them less likely to be defaulted on in the event the parent
19 company does go bankrupt. This is the case because there is no
20 more than a remote risk that the assets of the SPE could be pooled
21 with other assets of a utility if a bankruptcy judge decides to apply
22 the equitable notion of substantive consolidation, which allows for

1 the pooling of the assets and liabilities of technically distinct
2 corporate entities to satisfy creditor claims.

3 In conclusion, AAA bonds are deemed more valuable and less risky
4 than lower rated bonds, and securitized utility bonds similar to
5 those proposed by DEC and DEP are usually considered less risky
6 and more valuable than AAA rated bonds not secured by this
7 unique type of utility asset and issued by a bankruptcy remote SPE.

8 **Q. DOES THIS CONCLUDE YOUR TESTIMONY?**

9 A. Yes.