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E-7, Sub 1243

BEFORE: Chair Charlotte A. Mitchell, Presiding

Commissioner ToNola D. Brown-Bland

Commissioner Lyons Gray

Commissioner Daniel G. Clodfelter

Commissioner Kimberly W. Duffley

Commissioner Jeffrey A. Hughes

Commissioner Floyd B. McKissick, Jr.

IN THE MATTER OF:

Joint Petition of Duke Energy Carolinas, LLC, and Duke Energy Progress, LLC, for Issuance of Storm Recovery Financing Orders

VOLUME 2

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T A B L E O F C O N T E N T S 2

E X A M I N A T I O N S

EXHIBITS

IDENTIFIED/ADMITTED

P R O C E E D I N G S

CHAIR MITCHELL: Let's go back on the record, please. We will resume with questions for witness Heath by Commissioner McKissick.

COMMISSIONER McKISSICK: Thank you, Madam Chair.

EXAMINATION BY COMMISSIONER McKISSICK:

Q. Just before our break for lunch we were discussing the structure of the bond team and I guess the thing which I would like to get a clearer understanding of is how that bond team would be composed, and the powers -- whether powers would be coequal. It's my understanding that Duke doesn't have a problem with a bond team being established that would be composed of a Commission member, designee, as well as the advisor, financial advisor to the Commission, and that Duke would have their representative, as well as an independent consultant as an advisor and perhaps their counsel, is that correct? Is that the way you're proposing it? The way you envision it?

A. Yes, Commissioner. That's pretty much it. The decision-making authority would reside in the representative of the company and the designated commissioner or a member of the Commission staff as the two -- and those would be equal decisionmaking, coequal decisionmaking authority between those two. Anyone else there, you know, underwriters, the Public Staff and others would be kind of advising or making suggestions and reviewing documentation that gets put together for the transaction. But decisions would reside with the company and the commissioner or member of Commission staff.

Q. And I guess the other follow-up would simply -- would be the coequal partners would be agreeing on an underwriter or underwriters, as the case may be if there's more than one, the structure, the marketing, the pricing of the bonds and all of those issues, is that correct?

A. That is correct.

Q. Okay. Now, let me ask you this. I gather down in Florida there was a similar entity or bond team created and I gather there their public advocate group, I guess the Office of Public Counsel, participated in meetings, but they did not have a role in the decisionmaking. Is that the way that worked?

A. That's exactly right. So the OPC, the Office of Public Counsel, was invited to attend and participate and contribute in bond team meetings and they could review documents and offer suggestions. But they were not part of the decisionmaking authority, that's correct.

Q. Now, it's my understanding also that Duke has even gone at this point to identifying some firms that might be used by the Commission if they want to hire outside advisors, is that correct?

A. We gave some suggestions of firms that we know participate as -- or have participated in the past or in current transactions as Commission advisors. So yes, we laid those out in my rebuttal testimony, that's correct.

Q. I know that Saber has been working with the Public Staff, and likewise I guess they work with the Commission staff down in Florida as a financial advisor. But my understanding, they were not on the list of firms that you provided as recommended -- or those that might be appropriate to become involved as advisors here in North Carolina to the Commission, is that correct?

A. That's correct. But that's because they are already engaged in the advisory capacity or consultant capacity to the Public Staff. And so we would believe that if the Commission were to hire a consultant or an advisor, that it should be someone that's independent of the parties that the Public Staff and the company have already hired.

Q. Now, I know earlier there was the exhibit that was introduced, I guess involving statute 62-15, and it went down to, I guess, paragraph number 12 where it talked about, you know, what Public Staff involvement would be. And of course it says would deem necessary by the executive director in the interest of the consuming public, advise the Commission with respect to the securities, regulations and transactions pursuant to the provision of Article eight of this chapter. With that language being in there, I guess in North Carolina, I mean, would you view the Public Staff's ill advising the Commission on these issues, even though they would not have a formal role in decisionmaking, and Saber potentially being a consultant for them separate and apart from a financial consultant that the Commission might hire?

A. That's an interesting question. And quite honestly, I really haven't given any thought to, you know, whether the Public Staff's advisor could also be the Commission's advisor. That seems a little strange to me. And the fact that they would be advising both would seem -- I'm not sure that's -- you know, where would their responsibilities to the Commission versus the Public Staff reside. You know, we have concerns with the Public Staff being a joint decision maker for a variety of reasons. We see that role as being available to the Commission as it's been done in other states because of the responsibilities and the obligation the Commission has pursuant to the statute. And that would be things such as making findings of fact in the financing order and enabling -- or enabling the creation and transfer of the intangible property, right, to the SPE and enacting the true-up mechanism to make sure that enough cash and only enough cash is collected from customers to service the bonds, and then making the state pledge on behalf of the state to not impair that property right or disallow charges. So those are clearly obligations and responsibilities of the Commission. I do not see that the Public Staff directly participates in those things. So for me to say that A, I see a conflict there from the Public Staff advisor also playing the role of the Commission advisor, as well we would think that those would need to be separate parties. I don't think the Commission would be comfortable hiring Guggenheim Securities, our advisor, as its advisor in this transaction. So I don't know that it would be appropriate or -- you know, for the Commission to hire the Public Staff's advisor or to delegate that authority to the Public Staff.

Q. I understand. I guess I might not have stated my question clearly. The question was basically do you see the Public Staff and their advisor, Saber, let's say, if they remain the advisor for that to the public, being in a position to basically provide the Commission or the Commission designee with information? And of course it could be possible that the Commission would have its own separate independent financial advisor separate and apart from Saber. Would you see that potential to provide information -- and maybe the word advisor is not the best choice -- but to provide insight from their perspective to the Commission -- that's probably a better way of asking the question -- would be appropriate or not?

A. Yeah. And I think we have kind of laid that out. We do see a role for the Public Staff and its consultants here and it would be on the -- on the team, you know, calling in, participating and contributing to discussions of the bond team. And really advising and making comments to both the Commission and the company on what they believe is the best route to go. And then it would be the Commission designee and the company deciding whether the suggestion from the Public Staff and its consultant was the right course of action.

Q. Let me shift gears a bit. In terms of potential underwriters, would you envision using one underwriter or multiple underwriters as a part of an issuance?

A. Certainly for a transaction this size, almost a billion dollars, we think there should at least be two book running underwriters. And then probably a compliment of maybe four to six co-managers who would actually -- who would be involved as well and actively selling the bonds.

Q. You envision the possibility -- I know we have talked earlier today -- about selling all the bonds at one time. But how about the idea of doing the bond in tranches of a certain magnitude that might, you know, still stimulate and provide the type of interest that you would need and still provide the returns that everybody would feel appropriate, but not necessarily issuing a hundred percent of the time, theoretically I don't know what that number would be, but let's say it was decided 50 percent might be -- and another 50 percent in a separate tranche? Have you given thought to that and has that been done in other jurisdictions?

A. I believe it has been done in other jurisdictions and it's something I think we could consider here. We haven't put a lot of thought into it at this point. And primarily because I think in my view, and I think a fairly consistent view of most issuers is that the larger the transaction, the better. The larger a transaction, the better. So smaller transactions generally don't get as much attention from investors than a larger transaction. So a transaction -- especially a combined transaction like we're asking for flexibility for here of almost a billion dollars would get significant investor attention, we believe, and would have better execution than a 400 million dollar and a 600 million dollar issuance or something like that, right? And to kind of -- I want to -- I'm glad you asked that question because I do want to come back to, you know, a discussion that we had before lunch about this idea of if you can sell 95 percent of the bonds, is that a good result or whatever. And, you know, our goal here as we laid out in the financing application is that we want to fund and recover a hundred percent or the full amount of the storm recovery charges for both DEC and DEP. And yes, we could think about, you know, two different ways of doing that.

But, you know, our point -- a successful transaction in our mind is one that sells a hundred percent of the bonds, and we give a certification to this Commission that we, in fact, did achieve the lowest storm recovery charges that were available in the market at the date the bonds were priced and issued. And so if that's a successful transaction to us, you know, we could think about the idea of whether it's 50 percent now, 50 percent later. But this idea of, you know, can you fund 95 percent with these bonds and consider that a successful result, you know, we're requesting here to fund a hundred percent of the storm recovery cost and for us, that's a successful result. You know, issuing bonds for 95 percent and then going back and trying to recover the other five percent, I think that's kind of where the storm recovery rider doesn't seem to make a whole lot of sense to us. So I know that I went a little further than your question, but I hope I got your question answered in there as well.

Q. I appreciate your full, complete and more expansive response. I think that provides clarity and context.

Let me ask you this. In terms of marketing the bonds, I mean, do you intend to go beyond the traditional investors that would typically buy this type of bond product? I mean, how do you get and expand that market of potential investors and has thought been given to how that might be done? So you're going beyond the traditional investors.

A. You know, a lot of these securitizations have been done on shorter recovery periods. So seven years, 10 years, you know, and those attract -- like I was saying earlier, that shorter duration attracts one type of investor. When we start going out 15 years, 20 years, you're really having to go out and go to investors that haven't invested in -- or haven't invested heavily in these bonds. So you really want to reach out to traditional corporate investors on those. And so that's why we want to structure and align this issuance so that we're really kind of portraying this as a corporate issuance, rather than a structured finance or ABS, asset-backed security issuance. And so that gets you better execution, we believe. And we sell that in Florida. And then in terms of -- we want the broadest execution of this transaction as we possibly can get. And we believe that we were very successful at doing that in Florida where, you know, we didn't just have the investors go to their typical large accounts. We encouraged and we really pushed them to go to kind of, you know, smaller investors that may not be putting in the hundred million dollar or 50 million dollar order, but investors that might be wanting only 10 million or five million of bonds. So that's one way.

And then our other approach in Florida which, again, I mentioned this a second ago, I think we want to try to replicate here as well is to have these active co-managers involved. So a lot of times you have a co-manager involved and they aren't doing a whole lot of selling and that's not our philosophy. It wasn't our philosophy in Florida and it won't be our philosophy here. But we want co-managers who are actually going to be active and go out and market bonds. When we get into -- you know, especially some of these minority, or veteran, or women-owned firms that are smaller, they're not your Goldman Sachs, they're not your Morgan Stanleys, but it's like Williams Capital or, you know, Drexel Hamilton or

Ramirez & Company, those folks, they have relationships with much smaller, kind of niche investors and they can bring in, you know, investors who haven't maybe participated in these en masse in the past. Maybe they'll get a chance to participate in corporate bonds in general and they can bring those into these deals and drive some pricing competition.

Q. I think that would be excellent if firms such as that might be considered as this moves forward. Let me shift gears a little bit. Let me touch base on one thing you did say. You talked about the asset-based securities. In Florida they didn't do asset-based. They did ratepayer-backed securities the way we're talking about doing here, right?

A. The asset-backed is a -- is kind of a class of investments in the broader public debt market. So you can think of these two big pools of being corporate bonds and then asset-backed securities. And some of these earlier utility bonds that were done a couple decades ago may have been more seen as asset-backed securities. But that asset-backed nomenclature kind of gets people thinking of like issuances by credit card companies or issuance by automotive finance companies. And so those are much different than what we're dealing with here, right? You have got to worry about FICO scores of those individual loan holders and all those sorts of things, and there's default risk under these, you know, from individual accounts not being able to pay that get factored into that and those kind of things get packaged as -- with a lot of reserve, right? You put in really larger amounts of loans than you really need to cover the servicing of that debt because of those people who are going to default, right? But we don't have that here. I mean, we have with this true-up mechanism, yes -- that's why we think it's important to look at these as more of a project-type thing or a corporate bond and not an asset-backed security and that's our plan here. We will not register these as asset-backed securities. They will be on a registration statement called a form SF-1 which does encompass asset-backed securities, but it will be clearly noted that these are corporate bonds and they have been registered as such by the SEC.

Q. Just one or two follow-ups and that's simply this. You talked about the certifications. Now, I gather the certifications you're speaking of would be something that would essentially state that the way things were handled was compliant with the general statutes that are set forth in the general statutes. To what extent -- I gather Public Staff and Saber has talked about certain best practices that might be utilized or followed. What do you see as the challenges or problems that that would present in terms of certifications or in terms of other aspects of work that would be done related to these transactions? And more specifically, the way the bond team might address issues. Audio is off.

A. Sorry about that. So these best practices, there are some that have been outlined in the Public Staff consultant's testimony, and there seems to be when you read -- at least when I read the testimony, it almost is worded as such that we haven't done those best practices. That we're not committed to doing those best practices. And that is just not true. We have proposed that most of those best practices be implemented and that they are in fact in our transaction documents that -- or in the petition and in transaction documents that we have put forth. And so things like the Commission, you know, following the statutory requirements, right, and we believe that. So certifications was one of them. You asked about certifications specifically. And so, you know, I think their proposal is that you have certifications from, you know, the company, the Public Staff consultant, the underwriters. And that has happened in other jurisdictions, including Florida. But I would point out that the certification that we are proposing to make here goes further than the certification that we as an issuer, Duke Energy Florida and the SPE there, made in Florida. So in Florida that certification was effectively at -- the issuance of the bonds and the resulting storm recovery charge resulted in lower cost to customers than traditional regulatory recovery.

What we're proposing to certify to here is that the structuring, marketing and pricing of those bonds -- so I'll point to structuring, marketing and pricing, the statute only requires that we certify to the structuring and pricing of the bonds. But we are willing to certify to all three of those, that that process and the resulting charge is the lowest storm recovery charge available in the market at the date we issue those bonds. So by taking that added step, that we're certifying to the lowest cost standard, we don't believe that any other certification should be required in the Commission's evaluation of whether you accept or reject the issuance advice letter. You know, if other parties were to give a certificate, I'm not saying that you should ignore it or, you know, disregard it. But I think the only certification that should be a deciding factor in whether the issuance advice letter is accepted or approved should be the company's because we are certifying or we will certify to the lowest cost standard.

Q. This will probably be my last question, unless something else comes to mind. Have you ever been involved in a situation where you have gone through all of the -- the bonds are about ready to be issued -- I guess out in Texas they have got this two-day window where, you know, all the information comes back in, everybody goes back, reviews the data, they try to see if we're meeting the benchmarks, and if not they can issue, I guess, an order to suspend the issuance at that time.

Are you familiar with any jurisdiction where a decision has been made to suspend the bond issue at that time and to go back and -- to ground one, I guess, and begin to reevaluate whether the timing is right, the market or other circumstances are best to achieve the desired outcome with the bond issuance?

A. I am not aware of that having happened anywhere. That's not to say that it hasn't, but as I think really quickly about, you know, the 66 transactions that's been done in this space since, you know, the mid 1990s, nothing comes to mind where there was a stop order or a cancellation of a transaction on behalf of a Commission.

Q. Go ahead. I didn't mean to interrupt.

A. If I could, I want just to go back to that certification question. So the certification that we're giving here, we don't make that certification on any other debt issuance that we do at a utility, whether it's before this Commission or any other Commission. So that's something that's unique to these securitization bonds. And so I believe -- you know, the fact that the company is willing to put that certification in place, especially here in this transaction as a lowest cost standard, should give the Commission great comfort that we are taking every effort possible to get the best execution on this deal that we can because it's Duke's -- Duke -- you know, a Duke officer is going to be signing that certification saying we in fact got the best deal that was possible. And so I think that should alleviate a lot of concerns, you know, from the company. That's not a certification that we take lightly. So I just want to clarify that.

Q. The last follow-up would be, that two-day stop window to issue a stop order, that's what's being proposed in North Carolina as well, is that correct?

A. It's two or three days. I don't remember --

Q. Two or three?

A. We would price the bonds, we would put that letter together and put it before the Commission. It's two or three days where the Commission could act and say, you know, we're good with this result or, you know, we don't like this and put the brakes on this.

COMMISSIONER McKISSICK: Thank you, Mr. Heath. I don't have any further questions at this time.

Madam Chair, one thing I will bring to your attention, your video was flickering on my screen. I'm not sure if others were seeing that or not. Maybe it's some interference I'm experiencing. Thank you.

CHAIR MITCHELL: Thank you, Commissioner McKissick. If y'all lose me I'll do my best to get back on. Maybe something with the Internet service here in the building.

EXAMINATION BY CHAIR MITCHELL:

Q. Mr. Heath, I want to ask you a few questions and I'll be brief. My colleagues have already covered ground I was going to cover with you and you have been on the stand for a while now. So I want to move quickly through my questions so we can keep moving forward here.

But Commissioner McKissick was asking you about the issuance advice letter process and the proposal that the Commission have a period of time to issue a stop order. We'll just use the shorthand and refer to it as a stop order. So let's say for just -- let's say just for the sake of having this discussion that the Commission does in fact issue a stop order. So what would the company then do?

A. So that transaction would then not go forward, right? We would go to the underwriters and say hey, we're not going to be able to issue these bonds. We have an order that prohibits us from doing so. We basically pull that deal out of the market and then we have to figure out how do we go forward for recovery of those costs. And that could be, as I mentioned earlier to Commissioner -- I forgot who it was early this morning -- that that could be a transaction later, another bond transaction later, or it could be that we may have to seek recovery in the storm recovery rider if approved that we have asked for in the rate cases.

Q. So potentially you go through -- if you do not opt to recover under the traditional method in a general rate case proceeding and the company elects to go through the securitization proceeding again, you would start all over or what would the -- I mean, help me understand sort of the company's understanding of the process at that point in time.

A. You know, we talked this morning about whether there would be some end date -- you know, some date we have to issue by that could be put into the financing order. And so if there was no date there, I believe, and our attorneys could clarify, but I believe that that financing order would still be valid and we could then go -- you know, pull back, rethink things, figure out how to correct whatever the issue was that the Commission saw with that offering and then go back into the market at a later date under the same financing order.

Q. Okay. And I recognize in what the company would actually do in that circumstance would be dictated by the concerns that have been raised for the particular transaction. I just wanted to understand the company's understanding or proposal of the process. So thank you for that response.

You do testify -- I'm looking right now -- I'm looking at your direct testimony. You don't need to pull it. But you testified that for each month of delay beyond -- in your testimony it says May 31st but, you know, the targeted issuance date, the companies will continue to accrue carrying charges. And I believe it's company witness Abernathy that actually gives us specific numbers there. It's a million dollars for DEC and four million, I believe -- I'm just going off my recollection -- for DEP. And you testified that any delays will result in higher accrued carrying charges and ultimately higher bond issuance amounts.

What would cause delays -- first question for you. What would cause a delay? Why would there be a delay?

A. There really shouldn't be. But I mean, I think delays would be if, you know -- we put forth in that -- in our petition that carrying charges through May, we were contemplating a June, early June issuance, correct? So we heard this morning that we've made an application to delay the receipt of the financing order for 30 days. So that's a 30-day delay right there. So that's going to add some additional dollars to the bond issuance amount. If we had a bond team and for whatever reason, you know, those joint decision makers again that we're proposing be in the company and the Commission, if there were some dispute that we could not issue an agreement on and then we had to come back to the full Commission for some direction, that might add some time or just, you know, lengthy debates amongst those co-decision makers as to the best course of action, that could add some additional time. The SEC is going to take as long as they need to take in reviewing the registration statement. Our calendar is going to assume that's probably a four to five week process, I think, maybe four to six weeks. But they're under no obligation to act by a certain date, that I can recall. So that could take longer.

There's going to be a comment letter processed back and forth. So the more comments they ask, the longer it takes for us to address those comments and such. If there's multiple rounds of comments, that could delay things. You know, once we get into the ratings process -- you know, the rating agencies, S&P, Moody's, Fitch, they all understand this asset class very well, even though there are infrequent issuances of these bonds, but they understand the assets very well. So I don't really foresee what could cause delays with the ratings process. And then you really just get into what's the right time to get into the market from there.

Q. Okay. That's helpful to my understanding. I appreciate it.

CHAIR MITCHELL: All right. That's all I have. We will now take questions on Commissioner's questions. We'll start with CIGFUR.

MS. CRESS: Thank you, Chair Mitchell. CIGFUR does not have any questions for this witness.

CHAIR MITCHELL: Public Staff?

MR. CREECH: Yes, thank you, Chairman.

EXAMINATION BY MR. CREECH:

Q. Mr. Heath, thank you. I know it's been a long day. Just wanted to follow up on any number of questions that you received from the commissioners. As a preliminary matter I just wanted to ask you your view, the company's view on when the Commission's and the Public Staff's interest in achieving the lowest cost for the ratepayers would diverge. At what point in time would those interests diverge after the issuance of the financing order?

A. Are you looking at a point in time or like a theoretical --

Q. Whichever you prefer. I'm looking for some clarity.

A. So, you know, what we're proposing here, what I laid out in my rebuttal is that we see -- you know, if there's a bond team that the Commission wants to implement, we see that should be the Commission or a designated commissioner, member of Commission staff and the company as decision makers and the Public Staff participating in all bond team meetings and calls and looking at all documents. So I don't see that there's really any break there. You know, I think, you know, the Commission is tasked with looking at both the interest of the customer, as well as making sure that the utilities are financially viable and stable. So, you know, I see the Commission has that added role, right? Customer interest as well as company interest. You've got to balance the two. Where I see Public Staff is strictly a consumer advocate.

Q. Thank you. And on that point relating to ratepayer advocate, you have indicated about the certification that the company would be providing or willing to provide in this instance two kind of clarifying -- well, one clarification is would that be a lowest in fact standard certification? I couldn't -- it sounded like that's what you may have been saying just now, but I wanted to clarify that.

A. Well, it's what I read in the statute, right? That the issuance of the bonds and the resulting storm -- the resulting storm charge, storm cost charge, achieves the lowest cost to the customers.

Q. All right. And then in terms --

A. I'm probably misstating -- the issuance -- the structuring, marketing, and pricing of the bonds and the resulting storm securitization charge results in the lowest cost to customers.

Q. All right. And then in terms of certifications, you were discussing from whom the Commission should decide to receive them. But wouldn't it be beneficial to the Commission and to the ratepayers to receive a -- not withstanding receiving a certification from the company to whatever degree -- wouldn't it be beneficial again to the Commission, to the ratepayers to receive the certification from an independent or even a ratepayer advocate or an independent advisor like the Public Staff's consultants in this instance?

A. You know, I think what I said earlier was that I didn't -- I don't think the Commission should ignore one of those if someone were to deliver one to them. But, you know, I think that the fact that the company who makes no certification about its debt issuance cost and for its utilities is in fact going to certify to the lowest storm recovery charges available in the market on the day we price the bonds is adequate.

Q. Very good. And to be fair, just in this instance obviously, one reason you don't normally provide those certifications is because unlike a traditional issuance, in this instance these bonds are being paid back by the ratepayer?

A. All of our debt cost is paid for by our customers, whether they're securitization bonds or whether they're first mortgage bonds at the utility.

Q. We have covered that ground for today, sir.

Two other areas, if we could. One goes to the whole issue that several of the commissioners right off the bat got to, selling, you know, a hundred percent of the bonds, market pricing. In this transaction, you know, just to be clear, the lead underwriter, the book running underwriter will receive a fee or Commission for selling the bonds in this instance, isn't that correct?

A. All underwriters will receive some compensation for their efforts or for selling the bonds.

Q. Right. And then you have -- as part of your Exhibit-1, you've estimated that the fee that the underwriter will receive in this instance is, I think, approximately about a half percent, which is maybe 3.9 -- four to five million dollars, given what we know now?

A. Yes. So I put in there about 40 to 50 basis points. I kind of gave a range there. That's in the number of 3.9 to 4.9 or so.

Q. Right. And sometimes, like in the Florida transaction, the issuer of the bonds -- and here the issuer would be, I guess, the SBEs or the utilities, require that the lead underwriter accept some of the risk in the transaction. In other words, have some skin in the game, isn't that correct?

A. Yeah, that's true. And I think that would be based on facts and circumstances, decision on an individual transaction. So we were talking about earlier could we sell 95 percent versus a hundred percent or whatever. So yeah, I mean, I think if they -- we would have to look at the totality of what happened in the transaction and decide, you know, whether or not we want to try to -- we want to push those underwriters to take bonds to clear the transaction.

Q. Okay. And for the ratepayers obviously having the lead underwriter take on some risk presumably is a good thing because it means that they have a stake in the transaction. They're going to get paid regardless basically, I mean if the transaction goes through, will they not?

A. They're going to get paid when bonds are issued.

Q. Okay. And continuing on that point. I did want to briefly, if I can, Chair Mitchell, point to a premarked exhibit, 28, that is -- the various exhibits to witness Fichera's testimony. It's on page 448 of the consolidated premarked exhibits. Page 448. And this is premarked Exhibit-28. If I got that correct. Let me make sure that I've got that right. Let's see here.

A. Yeah, I'm looking at premarked Exhibit-28 and it starts out with Mr. Fichera's bio or resume.

Q. Right. And I misspoke. It's 1448. That's why I was -- I was looking at my numbers here. It's page 1448.

CHAIR MITCHELL: I have 1444 actually. But regardless, we're looking at -- the document we're looking at is some sort of C.V.

MR. CREECH: That's right. And my apologies. I would like to -- yes. Please. And I'm planning on scrolling down to page 1448, but I'm pleased to -- I'd like to enter this as Public Staff Heath Cross-Examination Exhibit-4. I believe that's correct.

MR. JEFFRIES: Chair Mitchell, this is Jim Jeffries. I may have missed an exhibit there, but I thought we were on Cross Exhibit-3.

MR. CREECH: That may be correct. Let's see here. I've got the list here.

MR. JEFFRIES: One were the statutes, two were the --

CHAIR MITCHELL: Right. We're on three.

MR. CREECH: Very good. Very good. My

apologies. Thank you, Mr. Jeffries.

CHAIR MITCHELL: All right. So we will identify the document. We will mark the document as Public Staff Heath Cross-Examination exhibit number three.

MR. CREECH: Thank you. Thank you, Chair.

(Public Staff Heath Cross Examination Exhibit 3 marked for identification.)

BY MR. CREECH:

Q. If you could scroll down, please, Mr. Heath, to page 1448.

A. I'm there.

Q. Which says Order Book Status. And, again, obviously this is discussed in witness Fichera's testimony, but this is a Credit Suisse Order Book Status, correct?

A. That's what it appears to be, yes. But -- yeah. It doesn't say what transaction it's related to, but that's what it appears to be, yes.

Q. Right. And if you look on -- if you go down, these are different tranches, tranche one, two, three, four and five.

A. Right.

Q. And you see on the right-hand side the percent subscribed starting at 121 percent for the first tranche, 118, 112, 96 and 131.

A. Correct.

Q. Okay. And just kind of going back to our prior point. This is a transaction that went through with all the tranches, but one oversubscribed by a good deal it appears. And this transaction I would -- in the present North Carolina transaction is it the company's contention that even if other tranches are oversubscribed, that this particular -- that storm securitization transaction in North Carolina issuance would not go forward unless and until all the tranches are fully subscribed?

A. Not necessarily. Again, it would depend on the dynamics of the book and the deal in total. So when we were talking about 95 percent versus 100 percent earlier, I think my comments were really thinking about of the total deal, not of an individual tranche. So 96 percent of a 68 million dollar out of a roughly 400 million dollar transaction wasn't fully subscribed. You know, I would think that, you know, in that case -- again, not even knowing what deal this relates to and not being intimately involved in that deal, I can't comment on specifics. But I would say that is a much bigger -- a much more different scenario than 95 percent of the total deal not being subscribed.

Q. Right. And just finally on that particular point, in a particular transaction where several percentage points -- several percentage of bonds are not -- there are no orders for them yet, the lead underwriter would take on those -- would take the risk of those bonds, correct? I mean, they would take ownership of the bonds and then have to resell them? Is that the way that would work?

A. Can you go through that whole scenario again?

Q. Well, I guess it's my understanding that obviously underwriters actually technically all purchase the bonds and then they are resold based upon orders. In this instance, if several percentage points in North Carolina are not -- they're not orders for those, the underwriter would hold them and it would behoove the underwriter, including based upon the fee that they're receiving and they have a stake in the process to sell those bonds?

A. They might. Depends on how -- what significance -- how much we're talking about here, right? If we're talking about half the deal, I don't see that playing out that way. If we're talking about a couple percentage points, it's very possible.

Q. Okay. We've covered this. Thanks for your patience on that particular topic. One more, if we may. In some of the questions today, including from Commissioner Clodfelter, there was discussion about the Commission's broad authority generally and within the securitization statute, including Subsection 12 that allows, quote, any other conditions not otherwise inconsistent with this section that the Commission determines are appropriate. And you stated that you were involved in the Florida -- in the DEF Florida transaction, and you may be aware or are you aware that the State of Florida has the same language in its statute and that the Commission there went on nonetheless in its financing order and required a lowest charge standard, is that correct?

A. That is correct. But I would point out that Commission -- you know, the Commission does have broad-based authority, and there's a provision in there that they can impose other conditions in the transaction that aren't inconsistent with it. I think it's really an interpretation as to how -- to the extent of what those conditions can be, right? I mean, the Commissions in each state operate differently from one another to some extent. The statutes that enable commissions to -- that give the commissions their authority have different language. And so I don't know that you can necessarily say well, the Florida Commission or the Texas Commission or the California Commission did X, Y, and Z, so the North Carolina Commission should do X, Y, and Z as well.

MR. CREECH: And with respect to those two items, I would like to place in the record, if I may, Chair Mitchell, premarked Public Staff Exhibits-2 and -3, which are Florida statutes and the Florida DEF financing order.

MR. JEFFRIES: Chair Mitchell, could I have just a moment to look at those real quick?

CHAIR MITCHELL: You may. Mr. Creech, are you seeking to have marked for identification Public Staff Cross-Examination exhibits two and three?

MR. CREECH: They would be --

CHAIR MITCHELL: Right. Is that what you're asking? So let's go ahead and mark them then. We'll mark -- assuming, Mr. Jeffries, that you don't have an objection, Public Staff Heath

Cross-Examination Exhibit number four.

MR. JEFFRIES: Chair Mitchell, it's not clear to me. Mr. Creech, do you intend to ask Mr. Heath any questions about these?

MR. CREECH: I was hoping to get them in. But we can move on. I think we may have covered that. I think it's a little bit of a hurdle here today, I think.

MR. JEFFRIES: I don't think there's any formal objection for awkwardness in the process. But I was going to suggest that maybe since these are public documents the Commission could take administrative notice of them.

MR. CREECH: Yes, that would be great.

CHAIR MITCHELL: All right. Why don't you make a motion for the Commission, the statute, so I understand specifically what you want us to take notice of.

MR. CREECH: Yes. Thank you, Chair Mitchell. I would like to ask that the Commission take administrative notice of the Florida statute in premarked two, which begins on page 22 of the consolidated exhibits provided to the Commission. And also premarked three which is the financing order for Florida Power & Light Company -- excuse me. I misstated that. For Florida Power & Light Company on page 55 of the combined exhibits.

CHAIR MITCHELL: All right. The Commission will take judicial notice of the Florida statutes, as well as order of the Florida Public Service Commission issued May 30, 2006 and docket 060038-DI.

MR. ROBINSON: Chair Mitchell, this is Camal Robinson -- oh, I'm sorry.

CHAIR MITCHELL: Hang on one second here. Mr. Creech, I would like for you to find at some point, perhaps on our first break, on our next break, the full citation to the Florida statute that you want us to notice, just so the record is clear.

MR. CREECH: Thank you. And those are all my questions.

CHAIR MITCHELL: Okay. So, Mr. Robinson, I see that you want to be heard, but we are now with you, you know, on Mr. Jeffries -- Mr. Robinson, you may proceed.

MR. ROBINSON: Chair Mitchell, thank you. I just have some logistics questions. I know we're going -- moving along with some of these exhibits, and I think it might be an appropriate time to maybe get some clarity on some things. Mr. Curran is not in this case so I think it's probably me to be the exhibits police this time around. An example, Public Heath Cross-Examination exhibit number three and I think two as well, they are, I believe, exhibits to testimony, and my question also is if they are marked in this docket as cross-examination exhibits and they're also exhibits to testimony, what is the appropriate nomenclature that you would like us to use, say, for briefs and things of that nature? It's just more of a clarity question as to which one would you prefer control.

CHAIR MITCHELL: Well, ideally we don't have them in the record multiple times. If we could work to avoid that, that would be ideal. But since we have already got these in the record now multiple times, let's refer to the cross-examination exhibit nomenclature or the nomenclature that we're assigning during the hearing.

MR. ROBINSON: Thank you, Chairman.

CHAIR MITCHELL: That I just think keeps the record clear. You can argue with me, but that's my preference at this time hearing nothing else from y'all. Okay.

Anything else, Mr. Jeffries?

MR. JEFFRIES: So Chair Mitchell, I have a couple of questions for Mr. Heath.

CHAIR MITCHELL: You may proceed.

MR. JEFFRIES: Thank you.

EXAMINATION BY MR. JEFFRIES:

Q. Mr. Heath, do you recall some questions -- and I apologize, I don't remember exactly who asked them to you -- but one of the commissioners asked you some questions about the decision not to include a storm reserve request in this proceeding. Do you recall that?

A. Yes, I do.

Q. Ms. Abernathy is coming up later on, hopefully later on today. Would she be in a position to also testify about the rationale behind the storm reserve decision?

A. Yes. Yes, she would.

Q. Perfect. At my peril, I'm going to return to the subject of certification again. As I understood your testimony earlier today, you said that the company intends to certify that the transactions at the time they close are consistent with the statutory lowest cost requirement, is that correct?

A. That is correct.

Q. And you have also indicated that you didn't necessarily see the value in it, but if other parties wanted to so certify as well and if the Commission found that to be useful, you didn't have any objection to the submission of those certifications, is that correct?

A. That's correct. I don't have an objection to -- I don't know that they add much for the transaction. But I do think that only the company's certification should be the ones that determine -- or that the Commission is using to determine whether or not to approve the transaction.

Q. At least as I understand the Public Staff's testimony, public staff's consultant's testimony on this point, one of the arguments they make is that if -- is that in order to provide a certification, they need to conduct independent due diligence of whatever the deal terms are that the bond team agrees to. Do you have -- are you equally as unconcerned about that proposal?

A. No, I'm very concerned about that proposal of anyone speaking to investors in this transaction other than the companies and potentially the Commission with respect -- and the Commission with respect to obligations, right, the findings of facts, the creating of the property, the enactment of the charges and the state pledge. I mean, all those things are fair game for the Commission to be in rating agency discussions and investor meetings commenting on. But, you know, I don't believe that any other party should be speaking to investors outside the company and the Commission and of course the underwriters.

Q. Can you explain why? I mean, what's your concern?

A. The biggest one would be with contractual law abilities, right? The companies as the issuer, so the company, the SPE, as issuers and co-registrants and the underwriters are the only two parties that will bear any sort of securities law liability in this transaction. Not the Public Staff. Not even the Commission. But we do -- like I said earlier, we believe there's ability for the Commission to be involved. We don't think though that the Public Staff can be that involved because of the loss of consistency of methods, there may be things that we -- that are said in a setting with an investor that we maybe are not aware of, especially if those discussions are done on a unilateral basis. If I don't know what has been said, I don't know what liability is being created.

Q. Are you concerned that it might potentially have any impact on the actual ability to conduct a deal?

A. Absolutely. I think there would be the potential that investors could be confused. Investors in these transactions become somewhat accustomed to seeing the Commission representative at the table and having discussions with them on particular aspects of the deal. But to introduce an intervening party like the Public Staff could create unnecessary confusion and detract from the deal.

Q. All right. I have one more question and it also relates to the certificate process to be provided by the company. And I want to be real clear on this because I think there's some confusion in the record. But as you read the statute 62172, and I think it's subsection B3 that requires this certification or this finding by the Commission, that obligation to breach that finding by the statute anticipates that that finding will be reached in the financing order. Do you agree with that? Is that your understanding?

A. Correct.

Q. Now, the certification you're talking about is going to occur much later in the process. If we use Mr. Creech's example, the certification of the financing order is going to take place in step one and then this certification you're providing is going to be at the end of the process, right?

A. Correct.

Q. All right. And is it going to be conditional -- the financing order obligation says, you know, it's got to be reasonably calculated and, you know, subject to market conditions. And I guess your ultimate certification will be subject to market conditions in reality, in practice. But, I mean is it going to be a certification that you have undertaken reasonable efforts to find the best cost -- or lowest cost or is it -- are you just going to certify it as the lowest cost?

A. It is a certification, the lowest cost being achieved.

Q. Okay.

MR. JEFFRIES: That's all the questions I have, Chair Mitchell.

CHAIR MITCHELL: All right. With that I will entertain motions from counsel.

MR. JEFFRIES: Thank you, Chair Mitchell. The companies would move that Mr. Heath's prefiled direct and prefiled rebuttal exhibits be entered into evidence as previously identified.

CHAIR MITCHELL: All right. Hearing no objection, Mr. Jeffries, your motion is allowed.

(Heath Exhibits 1, 2a - 2f and Confidential Heath Rebuttal Exhibits 1 and 2 were admitted into evidence.)

MR. JEFFRIES: And, Chair Mitchell, the companies would like to reserve their right to recall Mr. Heath at the appropriate time in the event that we feel like something else comes up in the interim that needs to be addressed by him.

CHAIR MITCHELL: All right. We will rebuttal that. Is that all for you, Mr. Jeffries?

MR. JEFFRIES: That is, Chair Mitchell.

CHAIR MITCHELL: Mr. Creech?

MR. CREECH: Yes. I'd like to move in

Public Staff Heath Cross-examination exhibits one through five.

CHAIR MITCHELL: Mr. Creech, I have three exhibits for you. We have taken notice --

(Reporter interruption due to sound issues.)

CHAIR MITCHELL: Mr. Creech, for purposes of the record, make your motion one more time.

MR. CREECH: I would like to move into the record Public Staff Heath Cross Examination exhibits one, two, three. One, two and three.

CHAIR MITCHELL: Okay.

MR. JEFFRIES: No objection, Chair Mitchell.

CHAIR MITCHELL: Thank you, Mr. Jeffries. Mr. Creech, the motion is allowed. All right.

(Public Staff Heath Cross Examination Exhibits 1, 2 and 3 were admitted into evidence.)

CHAIR MITCHELL: Mr. Heath, you may step down, but you are subject to being recalled. Thank you, sir.

THE WITNESS: Thank you. Understand.

Thank you.

CHAIR MITCHELL: All right. Duke, you may call your next witness.

MR. ROBINSON: Chair Mitchell, I know it's 2:30 and I also do know that there were some complications with hearing schedules and witnesses' availability tomorrow. Would it be possible to maybe just have two minutes to just maybe confer with counsel and potentially Mr. Creech or Mr. Grantmyre, maybe we need to touch base briefly to see if we call our next witness or if we allow witness Klein to step in front.

CHAIR MITCHELL: All right. Mr. Robinson, let's take a recess of five minutes. Will that give you all time?

MR. ROBINSON: Yes.

CHAIR MITCHELL: All right. Let's recess and we will back on in about, let's say, 2:40.

MR. ROBINSON: Thank you. Thank you, Chair Mitchell.

(A break was taken, 2:33 p.m. - 2:40 p.m.)

CHAIR MITCHELL: Mr. Robinson.

MR. ROBINSON: Yes, Chair Mitchell, counsel has conferred and Ms. Klein is able to go ahead of Mr. Atkins.

CHAIR MITCHELL: Thank you, Mr. Robinson. So we will hear from Public Staff witness Klein. Then we will resume with the company's presentation of its case. All right. Mr. Grantmyre, Mr. Creech, you may call your witness.

MR. GRANTMYRE: Yes. Ms. Klein will be Bill Grantmyre's witness and I do want to thank Duke for being so gracious to accommodate us. Thank you.

CHAIR MITCHELL: Let me have her affirmed before you begin, Mr. Grantmyre.

REBECCA KLEIN,

having first been duly affirmed, was examined and testified as follows:

CHAIR MITCHELL: All right. Thank you. All right, Mr. Grantmyre, you may proceed.

EXAMINATION BY MR. GRANTMYRE:

Q. Please state your name and your business address.

A. Rebecca Klein, 40 North Interstate Highway

35, Suite 1183, Austin, Texas 78701.

Q. And you are affiliated with Saber Partners and you're testifying on behalf of the Public Staff today?

A. I am.

Q. Did you cause to be prefiled in this case 35 pages of direct testimony and four exhibits?

A. Yes.

Q. If I were to ask you those same questions again today as to your direct testimony, would your answers be the same?

A. Yes.

MR. GRANTMYRE: Madam Chair, the Public Staff ask that her testimony be copied into the record as if given orally and the four exhibits be identified.

CHAIR MITCHELL: All right. Hearing no objection, Mr. Grantmyre, to your motion the prefiled testimony of Public Staff Witness Klein shall be copied into the record as if delivered orally on the stand. The extent of that testimony will be identified as it were when prefiled.

(Whereupon, the prefiled testimony of Rebecca Klein was copied into the record as if given orally from the stand.)

(Klein Exhibits 1 through 4 were identified as they were marked when prefiled.)

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, | ) | TESTIMONY OF |
| LLC and Duke Energy Progress, LLC | ) | REBECCA KLEIN |
| Issuance of Storm Recovery Financing | ) | PRINCIPAL, KLEIN |
| Orders | ) | ENERGY LLC |

**BEFORE THE NORTH CAROLINA UTILITIES COMMISSION**

**Docket No. E-2, Sub 1262**
**Docket No. E-7, Sub 1243**

**Direct Testimony of**

**Rebecca Klein, Klein Energy LLC**

**December 21, 2020**

## INDEX TO TESTIMONY



## INTRODUCTION

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

A. Rebecca Klein, Klein Energy LLC, 611 S. Congress Avenue, Suite 125, Austin, Texas 78704.

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

A. I am Principal of Klein Energy LLC, which specializes in regulatory representation and strategic entry and/or growth in domestic and international power markets.

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

A. Yes. I am sponsoring the following exhibits:

Klein Exhibit 1, the Financing Order dated August 5, 2002, issued by the Public Utility Commission of Texas in Docket No. 25230.

Klein Exhibit 2, the Financing Order (Order No. PSC-15-0537-FOF-EI) dated November 19, 2015, issued by the Florida Public Service Commission in Docket Nos. 150171-EI and 150148-EI.

Klein Exhibit 3, photocopies of "Asset Securitization Report – RRB sector leader Texas aims to set best practices," dated July 21, 2003; "Asset-Backed Alert," dated September 5, 2003; and "Asset Securitization Report, Oncor Electric Revitalizing an entire asset class," dated December 1, 2003.

Klein Exhibit 4, a redacted copy of the "lowest nuclear asset recovery charge" certification delivered by a bookrunning underwriter for Duke Energy Florida's 2016 issuance of securitized nuclear asset recovery bonds.

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

**Q. BRIEFLY PROVIDE AN OVERVIEW OF YOUR EDUCATION AND PROFESSIONAL EXPERIENCE.**

A. I am a graduate of Stanford University with a Bachelor of Arts degree in Human Biology. In addition, I received my Master's degree in National Security Studies at Georgetown University, earned a Juris Doctorate at St. Mary's University in San Antonio, Texas and am currently pursuing an Executive MBA at Massachusetts Institute of Technology. In 1996, I was admitted to practice law in Texas. I am also a retired Lieutenant Colonel in the U.S. Air Force Reserve. During this period of national service, I was awarded the National Defense and Southwest Asia Service Ribbons for service in Saudi Arabia during Desert Shield/Desert Storm.

From 2001-2004, I served as a Commissioner and also as Chair of the Public Utility Commission of Texas (PUCT), during which time I helped oversee the competitive restructuring of the State's $36 billion power market and the establishment of the PUCT's multibillion dollar Ratepayer-Backed Bond program in the state involving the first three ratepayer-backed bond offerings for three different utilities and approximately $3 billion in bonds. Prior to my appointment to the PUCT in 2001, I served as a Policy Director for then-Governor George W. Bush, engaging in a variety of statewide issues and projects in the areas of telecommunications, energy, housing, technology, and banking. I was also Chair and Vice Chair of the Board of the Lower Colorado River Authority, a public power entity that owns generation and transmission assets and manages hydro and other water assets in Texas. From 1988 to 1993, I worked in Washington, DC. I served as a Legislative Liaison Action Officer for the Secretary of the Air Force; as Associate Director, Office of Presidential Personnel in the White House of President George H.W. Bush; and as an Associate Director of the U.S. Trade and Development Agency, during which time I oversaw agency accounts in various multi-lateral banks. Presently, I sit as a member of the Board of Directors for a publicly traded utility, Avista Corporation, as well as a private corporation responsible for commercialization of renewable energy technologies.

**Q. PLEASE DESCRIBE THE NATURE OF YOUR RELATIONSHIP WITH SABER PARTNERS.**

A. Since 2006, I have been a member of the Advisory Board of Saber Partners, LLC (Saber Partners or Saber). Members of the Advisory Board make themselves available to Saber's senior management from time to time to give their perspective on issues in which Saber is involved. Members of the Advisory Board have no management or operational responsibility for Saber Partners. I often share my knowledge with Saber management on regulation and energy issues from a public policy point of view and from both the state and federal level perspective based on my extensive experience in those areas.

From time-to-time I also share with Saber my experience as Chair of the PUCT.

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

A. My testimony will explain the importance and the benefits of adhering to a **lowest storm recovery charge** standard when establishing a new Ratepayer-Backed Bond program and throughout all stages of structuring, marketing and pricing the proposed storm recovery bonds. My testimony also explains some of the actions that we took at the PUCT in tandem with our independent financial advisor that in fact resulted in the lowest transition bond charges consistent with market conditions and the terms of the Financing Orders. I will also discuss why the PUCT, having statutory fiduciary duty to the public interest, chose to retain a financial advisory team that was proactive and that would act as a co-lead with the utility throughout the transaction lifecycle. A fiduciary is required to act solely in the best interests of the beneficiary without regard to the fiduciary's own financial or other interests. Furthermore, I will explain the benefits of having a financial advisor, who is directed by an agency whose core responsibility is with consumer interest obligations, to act as an equal joint decision maker in collaboration with the utility involved in the Ratepayer-Backed Bond transactions. My testimony is based on my direct experience with three Ratepayer-Backed Bond transactions while Chair of the PUCT and participation with Saber's Advisor Board

Ratepayer-Backed Bond securitization transactions in Florida in 2006 and 2016 and West Virginia 2007 and 2009. My Florida experience related to the first use of Ratepayer-Backed Bonds in that state, to finance storm damage costs and to the second use of Ratepayer-Backed Bonds in that state, to finance the remaining costs of a nuclear generating plant which was retired early. My West Virginia experience related to the first use of Ratepayer-Backed Bonds in that state, to finance the costs of air pollution control facilities at a coal-fired generating plant.

## ESTABLISHING A STORM RECOVERY BOND PROGRAM BASED ON RATEPAYER-BACKED BOND "BEST PRACTICES"

**Q. DURING YOUR TERM WITH THE PUCT, WERE ANY RATEPAYER-BACKED BOND TRANSACTIONS COMPLETED?**

A. Yes. Three transactions were completed with active commission oversight during my tenure at the PUCT. Two transactions were done pursuant to Financing Orders issued by my predecessors and one pursuant to a Financing Order that I approved as a member of the PUCT. These transactions involved the issuance of Ratepayer-Backed Bonds referred to as "transition bonds" in Texas. Approximately $747 million in transition bonds were issued for Reliant Energy in 2001, $797 million in transition bonds were issued for Central Power and Light in 2002, and $1.3 billion in transition bonds were issued for Texas Utilities (Oncor) in 2003 and 2004.

**Q. WERE THOSE TEXAS "TRANSITION BONDS" SIMILAR TO THE STORM RECOVERY BONDS PROPOSED BY DUKE ENERGY CAROLINAS, LLC (DEC) AND DUKE ENERGY PROGRESS, LLC (DEP) IN THIS PROCEEDING?**

A. Yes. One overarching similarity between the storm recovery bonds proposed by DEC and DEP (the Companies) and the Texas "transition bonds" is that ratepayers bear the full economic burden of repaying the bonds. This is why they are often referred to as "Ratepayer-Backed Bonds." The utilities receive the proceeds determined through separate proceedings but the ratepayers are responsible for costs of issuance and principal interest on the bonds with no further review by the commission after the bonds are issued. This particular similarity is important because, as my testimony will explain, ratepayer interests in Ratepayer-Backed Bond transactions would not be represented but for the standards and actions incorporated into the transaction process by the regulator.

**Q. PRIOR TO THOSE THREE "TRANSITION BOND" TRANSACTIONS, DID THE PUCT SPECIFICALLY APPROVE ANY OTHER TYPES OF FINANCINGS FOR UTILITIES UNDER ITS JURISDICTION?**

A. No. Traditional financings and financing costs were under each utility's general cost of capital proceeding and were subject to a retrospective prudence review process by the PUCT in general rate cases. The utilities and their shareholders were directly accountable for all their debt costs and their capital structure under the general review process. If either item (debt level or cost of debt) was found to be imprudent, an adjustment would be made to the cost of capital.

**Q DID THE PUCT TREAT "TRANSITION BOND" TRANSACTIONS DIFFERENTLY THAN IT TREATED TRADITIONAL UTILITY BONDS OF THE INVESTOR-OWNED UTILITIES THAT YOU OVERSAW AS THE REGULATOR IN COST OF CAPITAL PROCEEDINGS AND RATE CASES?**

A. Yes.

**Q. WHY WERE THE TEXAS "TRANSITION BONDS" TREATED DIFFERENTLY?**

A. The normal incentives to minimize waste and eliminate inefficiencies that are inherent in traditional rate cases are absent with Ratepayer-Backed "transition bonds." Therefore, the PUCT's authority to correct any problems it discovered was severely limited. State law required the PUCT to issue an irrevocable Financing Order in which the utility is insulated from any and all costs associated with the financing. The PUCT was also required to approve an irrevocable process called a "True-up Mechanism" that committed the PUCT periodically to raise or lower the charge that supports the bonds to whatever level is necessary to pay the bonds' principal and interest on time. In addition, the State of Texas and the PUCT were required to pledge to the bondholders never to take or permit any action to be taken that would interfere with the bondholders' right to payment. This regulatory guarantee is an extraordinary use of the powers of state regulation. These items – the irrevocable Financing Order; the True-up Mechanism, and the pledge to bondholders – are all similar to legal obligations that the North Carolina statute requires for storm recovery bonds. In Texas, we adhered to these key commitments. They are essential in securing a AAA bond rating, which in turn mitigates debt costs and provides the opportunity, not a guarantee, for the lowest cost structure for ratepayers, as explained in further detail below.

**Q. WHY WAS AN IRREVOCABLE FINANCING ORDER REQUIRED WITH A TRUE-UP MECHANISM?**

A. The Texas legislature required a True-up Mechanism because the Texas utilities sponsoring the Texas securitization legislation advised that a True-up Mechanism was necessary to allow the "transition bonds" to be rated by the credit rating agencies at the highest category, "AAA," and make the "transition bonds" more attractive to investors. This feature would alleviate Underwriter and investor concerns (articulated by the credit rating agencies) that a future commission would make a determination that the financing was imprudent, much like a commission's ongoing retrospective review authority over traditional utility debt. The PUCT's independent financial advisor advised the PUCT that this was a correct analysis – that a True-up Mechanism was necessary to allow the "transition bonds" to be rated by the credit rating agencies at the highest category, "AAA".

**Q WHY DID THE TEXAS LEGISLATURE AND THE PUCT BELIEVE THAT AN "AAA" RATING WAS NECESSARY?**

A. The Texas utilities advised the Texas legislature and the PUCT that a "AAA" bond rating could result in the lowest possible interest rate on the "transition bonds." The PUCT's financial advisor supported this analysis. An "AAA" rating demonstrates to potential investors that the "transition bonds" are not very risky. The lower the risk, the lower the interest rate commanded by Underwriters and investors. Consequently, the credit rating is an important factor that allowed "transition bonds" to be sold to investors at the lowest possible interest rate at a given point in time and in turn at the lowest transition bond charges to Texas ratepayers.

**Q. DID THE PUCT IMPOSE OTHER CONDITIONS OR PROVISIONS IN ITS FINANCING ORDERS TO IMPROVE THE**

**MARKETABILITY OF TEXAS "TRANSITION BONDS" AND LOWER THE OVERALL COST TO RATEPAYERS?**

A. Yes. The Texas statute required that the "structuring and pricing" of transition bonds result in the lowest transition bond charges consistent with market conditions. In its Financing Orders, the PUCT also required that the "marketing" of transition bonds result in the lowest transition bond charges consistent with market conditions.

In addition, the PUCT's Financing Orders directed its financial advisor in each transaction in which I was involved to be actively engaged throughout the transaction process in order to adhere to a lowest transition bond charge standard. Examples of the proactive initiatives the independent financial advisor undertook to help us reach our "lowest transition charge" mandate include: 1) insisting that any servicing fees and administration fees in excess of actual incremental costs be rebated or credited to ratepayers; 2) identifying any potential conflicts that may arise between the utility, the Underwriter and the utility's advisor; 3) participating fully and in advance in all aspects of structuring, marketing and pricing the "transition bonds"; 4) challenging any decision it believes might not result in lowest transition bond charges to ratepayers; and 5) requiring certifications from the Companies, the bookrunning underwriter(s) and the PUCT's financial advisor that the structuring, marketing and pricing of the transition bonds in fact resulted in the lowest transition bond charges consistent with market conditions at the time the transaction priced and the terms of the Financing Order (see Klein Exhibit 4). Public Staff witnesses Hyman Schoenblum, Paul Sutherland and Joseph Fichera have outlined more fully in their testimonies these conditions and provisions that were adopted and implemented in connection with the Texas "transition bonds" to lower the transition bond charges to ratepayers in Texas. Klein Exhibits 1 and 2 provide two Financing Orders exemplifying these required conditions. Klein Exhibit 1 is the PUCT's 2002 Financing Order which authorized the Texas Oncor securitized "transition bond" transaction, with yellow highlighting indicating language which implements "best practices" recommended by Saber Partners. Klein Exhibit 2 is the Florida Public Service Commission's 2015 Financing Order which authorized Duke Energy Florida's securitized nuclear asset recovery bonds, again with yellow highlighting indicating language which implements "best practices" recommended by Saber Partners. The Florida commission used the PUCT's 2002 Financing Order as its template.

**Q. IN WHAT WAYS DO YOU BELIEVE YOUR EXPERIENCE WITH TEXAS "TRANSITION BONDS" SHOULD INFORM THE NORTH CAROLINA UTILITIES COMMISSION AS IT PREPARES A**

**FINANCING ORDER FOR THE PROPOSED STORM RECOVERY BONDS?**

A. Absent a pro-active approach by an entity having specific statutory responsibilities to consumers, the North Carolina ratepayers will not be represented meaningfully in the process of structuring, marketing and pricing the bonds. Without adherence to a clear, unqualified lowest storm recovery charge standard by the North Carolina Utilities Commission (Commission) and adoption of practices, procedures and advice from an independent financial advisor, it will be difficult to hold utilities and Underwriters of storm recovery bonds accountable for any failure to achieve the best possible outcome for ratepayers. It is important to remember: The Commission gives up all further review of the charges imposed on ratepayers once the bonds are issued and non-bypassable charges imposed on ratepayers. Payment of all principal, interest and other financing costs are paid directly by ratepayers. Every dollar is a ratepayer dollar. Moreover, with the True-up provision, the Commission must guarantee to adjust the charge to whatever level is necessary to repay the bonds on time. There is no chance to look back as with traditional utility bonds and cost of capital.

**Q. IN YOUR OPINION, SHOULD THESE OTHER CONDITIONS OR PROVISIONS BE IMPOSED TO IMPROVE THE MARKETABILITY OF NORTH CAROLINA STORM RECOVERY BONDS AND**

**LOWER THE SECURITIZED CHARGES TO NORTH CAROLINA RATEPAYERS?**

A. Yes. In my experience with three Ratepayer-Backed Bond transactions in Texas, the PUCT was able to realize an average ratepayer savings for the three transactions of $23 million ($17 million net present value taking into account all costs), as compared to the pricing of other Ratepayer-Backed Bonds during the same time frame. See Sutherland Exhibit 3 and witness Sutherland's description thereof. I believe that these substantial ratepayer savings resulted directly from the PUCT's steadfast adherence to the lowest transition charge standard that was fully aligned with ratepayer interests. Further, these ratepayer savings were directly attributable to the fact that the PUCT, supported by the specialized expertise of its financial advisor, was actively involved in developing and implementing the terms, conditions and provisions of each facet of the transaction process. The testimony of Public Staff witness Sutherland explains in more detail how these transactions priced relative to other investor-owned utility Ratepayer-Backed Bond transactions. As Mr. Sutherland explains with specificity, the superior outcome of these initial Texas Ratepayer-Backed Bonds has been confirmed by several other industry observers when compared to Ratepayer-Backed Bond transactions in other states that did not take a similar approach. The success of the Texas approach was also noted by independent financial press reports at the time, particularly the 2003 Oncor Ratepayer-Backed Bond offering. In Klein Exhibit 3, I have attached copies of several of these articles from third party observers.

**Q. DID THE TEXAS STATUTE WHICH AUTHORIZED RATEPAYER-BACKED BONDS DIRECT THE PUCT TO APPLY A STANDARD TO ENSURE THAT BENEFITS FROM THE LEGISLATION AND THE FINANCING ORDER TO TEXAS RATEPAYERS WOULD BE MAXIMIZED?**

A. Yes. The Texas statute required the PUCT to ensure that the structuring and pricing of the securitized "transition bonds" resulted in the lowest transition bond charges consistent with market conditions and the terms of the Financing Order. After public hearings on the proposed Texas Ratepayer-Backed Bond program, the PUCT determined that effective marketing of transition bonds would be integral to a successful pricing of transition bonds; therefore, the PUCT Financing Orders made express that the "structuring, marketing and pricing" of the transition bonds must result in the lowest transition bond charges consistent with market conditions and the terms of the Financing Order. The Texas statute, like the North Carolina statute, directs the PUCT to evaluate Financing Order petitions and add the necessary conditions to protect ratepayer interests while validating the necessary funds to be given to the utility. We acted in our fiduciary role for both ratepayer and utility interests.

**Q. WHY IS AN UNQUALIFIED "LOWEST SECURITIZATION CHARGE" STANDARD IMPORTANT?**

A. A lowest securitization charge standard sets the appropriate benchmark on behalf of the ratepayer. I fully acknowledge that there are no absolutes in this world. Nevertheless, the lowest securitization charge standard is a prudent and reasonable objective that should be treated as the "guiding star" in every phase of the transaction cycle not only for the Commission, but also for the utility and in the context of negotiations with Underwriters and investors.

**Q IN THE ABSENCE OF A SPECIFIC STATUTORY MANDATE, WHAT WOULD YOU HAVE DONE AS A PUCT COMMISSIONER?**

A. The same thing. Even if this statutory mandate had not been included in the Texas legislation, I would have pursued the lowest cost to ratepayers for the very simple reason that this was the PUCT's fundamental responsibility to ratepayers under our general statutes. I would have felt particularly strongly about this in any situation where the intrinsic nature of a transaction does not account for ratepayer interests in equal measure as the sponsoring utility, as is the case in this proceeding.

**Q. ARE RATEPAYER INTERESTS CLEARLY ALIGNED WITH THE COMPANIES' INTERESTS IN THIS CASE?**

A. No. In Ratepayer-Backed Bond transactions generally, the utility has an interest in closing the transaction as expeditiously as possible, even if that requires the utility to settle for less than the lowest storm recovery charges to ratepayers. In each of the Ratepayer-Backed Bond transactions in which I was involved, the utility was to receive hundreds of millions of dollars but without any direct or indirect obligation to pay it back. The utility's interests were already protected by the nature of the transaction. While the utility had a general interest in keeping overall customer rates low, the utility had another, more immediate and compelling interest in getting the proceeds as quickly as possible. This eliminates the uncertainty over the recovery of funds and gives the utility the proceeds from the bonds to use in their business operations to help maximize returns for shareholders. I have no reason to believe that the Companies' interests in this transaction would be any different. Having said that, there is no reason why ratepayer interests and the Companies' interest cannot be aligned in light of the fact that any savings that could benefit ratepayers do not affect the amount the utilities will receive as part of the securitized amount. However, it is important that ratepayers be represented at the negotiating table with the utility when it enters the market and negotiates with Underwriters and investors whose interests are clearly not aligned with either the utility or the ratepayers.

**Q. DID THE TEXAS UTILITIES SUPPORT ACTIVE INVOLVEMENT OF THE PUCT'S EXPERTS IN THE PROCESS AND IN THE NEGOTIATIONS WITH UNDERWRITERS?**

A. The Texas utilities eventually did support the active involvement of the PUCT, particularly when they realized the PUCT's steadfast resolve to adhere to a process that increased the probability of realizing the lowest cost standard. There was some pushback during the course of discussions to negotiate the best terms for Texas ratepayers — rather than just follow what other utilities and their bankers were doing in other states. We viewed this as a natural part of the robust negotiating process in the capital markets. However, with the PUCT's firm commitment and support to the process, the transactions were completed, the utilities received their proceeds and the ratepayers were optimally protected.

**Q. DOES THE NORTH CAROLINA STATUTE AUTHORIZING SECURITIZATION OF STORM RECOVERY COSTS HAVE AN EXPRESSLY STATED REQUIREMENT THAT THE COMPANIES**

**STRIVE TO ACHIEVE THE "LOWEST STORM RECOVERY CHARGES"?**

A. Yes. I have reviewed the North Carolina statute authorizing storm recovery costs. N.C. Gen. Stat. § 62-172(b)(3)b. directs the Commission in its Financing Order to determine if the "structuring and pricing" of 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 of the Financing Order. It also directs the Commission to include in its Financing Orders "[a]ny other conditions not otherwise inconsistent with this section that the Commission determines are appropriate."

**Q. YOU STATED THAT N.C. GEN. STAT. § 62-172(b)(3)b. DIRECTS THE COMMISSION TO INCLUDE IN ITS FINANCING ORDERS "ANY OTHER CONDITIONS NOT OTHERWISE INCONSISTENT WITH THIS SECTION THAT THE COMMISSION DETERMINES ARE APPROPRIATE." BASED ON YOUR OVERSIGHT OF THE INITIAL THREE RATEPAYER-BACKED BOND ISSUES AS CHAIR OF THE PUCT, SHOULD THE COMMISSION'S FINANCING ORDERS INCLUDE ADDITIONAL TERMS,**

**CONDITIONS AND PROCEDURES DESIGNED TO ACHIEVE THE "LOWEST STORM RECOVERY CHARGES"?**

A. Yes. The Commission's Financing Orders should require the "structuring, marketing and pricing" of storm recovery bonds result in the lowest storm recovery charges consistent with market conditions at the time storm recovery bonds are priced and the terms of the Financing Order. I also believe the Commission's Financing Orders should require compliance certificates to be delivered by the Companies, the Public Staff or its financial advisor, and the book-running manager after pricing stating that the "structuring, marketing and pricing" of storm recovery bonds in fact have resulted in the lowest storm recovery charges consistent with market conditions at the time storm recovery bonds are priced.

JOINT DECISION-MAKING AUTHORITY WITH SUPPORT FROM AN INDEPENDENT FINANCIAL ADVISOR

**Q. SHOULD THE COMMISSION'S FINANCING ORDERS INCLUDE OTHER ADDITIONAL TERMS, CONDITIONS AND PROCEDURES DESIGNED TO ACHIEVE THE "LOWEST STORM RECOVERY CHARGES"?**

A. Yes. In my view, and based on my oversight of three Ratepayer-Backed Bond issues as Chair of the PUCT, it will be difficult or perhaps even impossible for the Commission to make this after-the-fact determination that the structuring, marketing and pricing of the

Companies' offerings achieved the "lowest storm recovery charge" with confidence unless the Commission Staff, the Public Staff and an independent financial advisor are involved as joint decision makers in all aspects of the structuring, marketing and pricing of the storm recovery bonds through the time when the utilities file their issuance advise letters and when the Commission has authority to disapprove the bond offering. Receiving only timely information and updates from the utilities and Underwriters as currently proposed by the joint petition is not enough.

**Q. HOW DID THE PUCT PROTECT THE PUBLIC INTEREST AND ASSURE ITSELF THAT IT MET ITS LEGISLATIVE DUTY?**

A. For the three Texas "transition bond" transactions I oversaw as Chair of the PUCT, we established a process of active and involved oversight throughout the transaction lifecycle. The PUCT was a joint decision maker with the sponsoring utility in all matters relating to the structuring, marketing, and pricing of the "transition bonds." We expected the utility to work on a collaborative basis with PUCT staff and the PUCT's independent financial advisor to ensure a successful transaction at the lowest storm recovery charge to ratepayers.

PUCT staff and the PUCT's independent financial advisor also participated actively and were joint decision makers with the utility in the process of structuring, marketing and pricing the "transition bonds." They acted as an informal "Bond Team." In addition, the

PUCT required a detailed issuance advice letter process and certification of what was done during the transaction, the choices made and the efforts expended, explaining how these efforts led to the lowest transition bond charges to ratepayers.

IMPLEMENTING A FIDUCIARY DUTY TO RATEPAYERS

**Q. DO THE STATE OF TEXAS STATUTES PROVIDE FOR A DIVISION OF THE PUCT OR A SEPARATE STATE AGENCY TO REPRESENT THE INTERESTS OF ALL ELECTRIC RATEPAYERS?**

A. No. Whereas, Chapter 13 of the Texas Public Utility Regulatory Act establishes a separate Office of Public Utility Counsel to advocate specifically for residential and small commercial electric ratepayers, the Texas statutes do not provide for a particular division of the PUCT nor a separate state agency to represent the interests of **all** electric ratepayers.

**Q. N.C. GEN. STAT. § 62-15(b) ESTABLISHES WITHIN THE COMMISSION A PUBLIC STAFF TO REPRESENT THE INTERESTS OF THE ENTIRE "USING AND CONSUMING PUBLIC" THROUGHOUT NORTH CAROLINA. THE PUBLIC STAFF IS AN INDEPENDENT AGENCY WHICH IS NOT SUBJECT TO THE SUPERVISION, DIRECTION, OR CONTROL OF THE COMMISSION. N.C. GEN. STAT. § 62-15(d) STATES "IT SHALL**

**BE THE DUTY AND RESPONSIBILITY OF THE PUBLIC STAFF TO: . . . INTERVENE ON BEHALF OF THE USING AND CONSUMING PUBLIC, IN ALL COMMISSION PROCEEDINGS AFFECTING THE RATES OR SERVICE OF ANY PUBLIC UTILITY". DO YOU BELIEVE IT WOULD BE APPROPRIATE TO INCLUDE THE PUBLIC STAFF IN ANY "BOND TEAM" ESTABLISHED BY THE COMMISSION'S FINANCING ORDERS TO PARTICIPATE ACTIVELY AND BE JOINT DECISION MAKERS WITH THE COMPANIES IN THE PROCESS OF STRUCTURING, MARKETING AND PRICING THE STORM RECOVERY BONDS?**

A. Yes. As petitioners, the Companies are parties to the Commission proceeding and are expected to participate on the Bond Team with a view to protecting their own interests. I believe Public Staff's participation on the Bond Team would enhance the symmetry of ratepayer interests and viewpoints. The testimonies of Public Staff witnesses Schoenblum and Fichera discuss this as well. The Public Staff, given its express legislative mandate to advocate and protect ratepayers, should also be included as a member of the Bond Team.

**Q. DO YOU BELIEVE THE RATEPAYER-BACKED BOND TRANSACTIONS WHICH YOU OVERSAW AS CHAIR OF THE PUCT WERE SUCCESSFUL IN MAXIMIZING BENEFITS TO TEXAS RATEPAYERS?**

A. Yes.

**Q. WHAT IS THE BASIS FOR YOUR BELIEF?**

A. The Texas Financing Orders required the utility to file a detailed set of analyses and representations called an “issuance advice letter” about the pricing of the bonds, documenting the benefits of the transaction to ratepayers.

The PUCT also established a detailed procedure of active due diligence on the part of its staff and expert advisors. These staff and expert advisors were assigned to present to the PUCT their review of the issuance advice letter once filed, as well as their assessment of whether the structuring, marketing, and pricing of the “transition bonds” in fact achieved the lowest transition bond charges to ratepayers consistent with market conditions and the terms of the applicable Financing Order. For each transaction, the PUCT noticed a hearing within two business days after pricing for the purpose of issuing a stop order if the PUCT was not convinced that the lowest transition bond charge objective in fact had been achieved.

Throughout the period leading up to pricing, and continuing for two business days after pricing, the PUCT reviewed this pricing information with staff and decided whether to issue a stop order. The due diligence review was both in real time and after-the-fact, so that the PUCT’s hands would not be tied as a practical matter. The PUCT also reviewed specific lowest transition bond charge certifications as to the structuring, marketing, and pricing of the bonds from the utility, as well as from the Underwriters and from independent experts without any potential conflicts of interest. The factors considered by the PUCT included (a) pricing relative to benchmark securities; (b) pricing relative to other similar securities at the time of pricing, and (c) the amount of orders received and from whom.

Attached to my testimony is an issuance advice letter used in one of the Texas "transition bond" transactions I oversaw as Chair of the PUCT. See Klein Exhibit 1.

**Q. DID THE PUCT USE OUTSIDE ADVISORS IN CONNECTION WITH THOSE RATEPAYER-BACKED BOND TRANSACTIONS?**

A. Yes. The PUCT realized it did not have the expertise on staff for this assignment, so we brought in an expert independent financial advisor without any potential for conflicts of interest. As part of this engagement, through its financial advisor, the PUCT also had the benefit of outside legal counsel of Orrick, Herrington & Sutcliffe LLP, as the Public Staff does here. The PUCT acted by and through these advisors to ensure that the ratepayers' interests were protected. Personally, I felt it was my fiduciary duty to the public interest to engage an independent financial advisor to guide us through all stages of these initial Ratepayer-Backed Bond transactions. Being a lawyer, I had no knowledge or experience in this complex area of finance. Nor did my fellow commissioners. The PUCT finance staff was experienced with traditional regulator financial matters. However, securitized Ratepayer-Backed Bond transactions were new to us all. It was helpful to have outside expertise help the PUCT establish an understanding and culture of Ratepayer-Backed Bond best practices that the PUCT could then utilize on its own in future Ratepayer-Backed Bond transactions.

## STRUCTURING, MARKETING AND PRICING WITH CERTIFICATIONS FROM UTILITY, UNDERWRITERS AND AN INDEPENDENT ADVISOR

**Q. DID THE PUCT AND THE PUCT'S FINANCIAL ADVISOR PLAY AN ACTIVE ROLE IN STRUCTURING, MARKETING, AND PRICING THE RATEPAYER-BACKED BONDS?**

A. Yes. The PUCT's financial advisor was diligent in identifying areas in which ratepayer costs could be reasonably mitigated within the context of prevailing market conditions. The PUCT's financial advisor was also meticulous in providing the PUCT with cost comparisons between the then-current transaction and the same costs in past Ratepayer-Backed Bond transactions so that the PUCT could have a framework in which to make decisions on terms, conditions, marketing, and timing. This type of active participation on the part of the financial advisor helped the PUCT meet its goal of ensuring the lowest transition bond charge standard was met.

**Q. DID THE PUCT REQUIRE A LOWEST TRANSITION BOND CHARGES CERTIFICATION FROM ITS FINANCIAL ADVISOR?**

A. Yes. In the open meeting on February 25, 2000, the PUCT discussed the need for an independent financial advisor to provide a fully accountable opinion or certification as to the lowest cost of funds as one item the PUCT would examine in deciding whether to approve the transaction immediately after pricing. The PUCT understood that the work required to give that certification was substantial and could add to the cost of the transaction. However, the PUCT believed the benefits would exceed the costs and that the certification, like an insurance policy, would provide protection that our mandate would be met.

**Q. DO YOU THINK IT IS APPROPRIATE FOR THE COMMISSION TO REQUIRE CERTIFICATIONS THAT THE LOWEST STORM RECOVERY CHARGE HAS, IN FACT, BEEN ACHIEVED?**

A. Yes. The PUCT lowest cost certifications were required, pursuant to the Financing Order, from the sponsoring utility, the lead Underwriter and the PUCT's independent financial advisor in each of the three transition bond issues I oversaw as Chair of the PUCT. I believe the requirement that these lowest transition bond charge certifications be delivered was an important element in achieving superior results in each of those three transactions for the benefit of Texas ratepayers. It was important to us that the independent financial advisor who had a fiduciary duty to the PUCT and ratepayers deliver the certification. They had no financial interest in the outcome of the bond offering, unlike the utilities and the Underwriters. Their opinion was the core component of the Financing Orders that established the Ratepayer-Backed Bond program. Public Staff witnesses Schoenblum and Moore also discuss the need for, and relevance of, independent advisor opinions in financial transactions when someone acting in a fiduciary role must make a decision affecting the interests of the people it represents. In this case, it was the PUCT acting for the ratepayers.

**Q. IN YOUR EXPERIENCE, DID THE DIVISION OF RESPONSIBILITIES PROPOSED BY SABER PARTNERS AND THE RESULTING INCENTIVE STRUCTURE LEAD TO A COLLABORATIVE AND COLLEGIAL PROCESS?**

A. Yes. It should be the same in this case as well, but only if the sponsoring utility and the Underwriters are dedicated to, and do not resist or undermine, a collaborative and collegial process. But my answer would be “No” if the sponsoring utility and/or the Underwriters are determined to resist or undermine a collaborative and collegial process.

**Q. CAN YOU PROVIDE AN EXAMPLE OF HOW THAT COLLABORATIVE AND COLLEGIAL PROCESS WORKED TO THE BENEFIT OF RATEPAYERS IN THE TEXAS "TRANSITION BOND" TRANSACTIONS?**

A. Yes. As explained in greater detail in the testimonies of Public Staff witnesses Sutherland, Heller and Fichera, Ratepayer-Backed Bonds represent a joint and several liability of all ratepayers which is a unique characteristic of Ratepayer-Backed Bond structures. In addition, such bonds are structured with a True-up Mechanism contained in the Financing Order. This mechanism allows the storm recovery charge to be adjusted at least semi-annually, pursuant to a pre-approved formula, to ensure the principal and interest is paid on time. Thus, if there were an unexpected decline in energy sales for some period, the charge per kWh could be increased subsequently to make up for the lower collections. This also protects against increases in write-offs and delinquencies. A number of prior Ratepayer-Backed Bonds have been offered pursuant to SEC registration statements which provided detail about the unusual and superior credit quality of the securities. For example, the U.S. Securities and Exchange Commission registration statement for securitized "transition bonds" issued in 2004 for the benefit of Texas Utilities included the following language:

> The broad-based nature of the true-up mechanism and the State Pledge will serve to effectively eliminate, for all practical purposes and circumstances, any credit risk to the payment of the transition bonds (i.e., that sufficient funds will be available and paid to discharge the principal and interest obligations when due).[1]

Saber's records indicate that this description of the "credit risk" was proposed by Hunton & Williams, legal counsel to Texas Utilities.

**Q. WHAT WOULD MAXIMIZE THE CHANCE OF THE PROCESS BEING COLLABORATIVE AND COLLEGIAL IN THE PROPOSED STORM RECOVERY BOND TRANSACTION?**

A. The Commission should clarify that ultimate decision-making authority for all aspects of structuring, marketing and pricing the proposed storm recovery bonds rests with a designated member of the Commission, and that day-to-day decision-making authority rests with a Bond Team which includes designated Commission Staff, the Public Staff, their respective financial advisors, and the utilities. In their testimonies in this proceeding, Public Staff witnesses Schoenblum and Fichera discuss this Bond Team approach. This ensemble represents the voices of all interested parties and can collaboratively achieve the "lowest storm recovery charge" mandate through robust and transparent negotiation.

[1] TXU Electric Delivery Transition Bond Company LLC. Issuer, Oncor Electric Delivery Company, Seller and Servicer, Transition Bonds, dated May 28, 2004, Prospectus at page 56 (https://www.sec.gov/Archives/edgar/data/1100179/000095012004000393/d598648.txt).

**Q. DID THE PROCESS FOR STRUCTURING, MARKETING AND PRICING THE THREE ISSUANCES OF SECURITIZED "TRANSITION BONDS" WHICH YOU OVERSAW AS CHAIR OF THE PUCT, AND WHICH APPLIED MANY OF THE "BEST PRACTICES" DESCRIBED BY PUBLIC STAFF WITNESS PAUL SUTHERLAND, INVOLVE ADDITIONAL LEGAL AND FINANCIAL ADVISORY FEES?**

A. Yes. The PUCT retained an active financial advisor in each of those three transactions, knowing full well that this likely would involve increased legal and financial advisory fees.

**Q. LOOKING BACK, DO YOU BELIEVE THE DECISION TO RETAIN AN ACTIVE FINANCIAL ADVISOR IN EACH OF THOSE THREE TEXAS "TRANSITION BOND" TRANSACTIONS BENEFITED TEXAS RATEPAYERS, NOTWITHSTANDING THAT THOSE RATEPAYERS WERE REQUIRED TO ABSORB MOST OR ALL OF THE COSTS OF THOSE INCREASED LEGAL AND FINANCIAL ADVISORY FEES?**

A. Yes. These upfront costs represented an investment in sound legal and financial advice to protect ratepayer interests in negotiations with parties who did not have a fiduciary duty to their interests. All those parties on the other side of the negotiating table were well represented by experts and legal counsel, and there needed to be appropriate checks and balances in the negotiating process. It was both an investment and an insurance policy. Post-issuance reports submitted to the PUCT by its financial advisor, the Underwriters as well as independent market observers all concluded that all three of those initial Texas Ratepayer-Backed transition bond offerings provided substantial increased overall net present value savings to Texas ratepayers. Detailed information about those overall net present value savings to Texas ratepayers is included in the testimony of Public Staff witness Sutherland.

**Q. DO YOU HAVE A CONCLUSION AS TO WHETHER THE INCREMENTAL COSTS OF THE ACTIVE FINANCIAL ADVISOR APPROACH IN TEXAS WERE JUSTIFIED BY SAVINGS IN OVERALL COSTS?**

A. Yes. The incremental costs of the active financial advisor approach in each of the three Texas Ratepayer-Backed transition bond transactions I helped oversee as Chair of the PUCT were easily justified by savings in other issuance costs and savings in interest costs. They also provided the PUCT with the assurance that nothing went wrong or was done that was not for the benefit of ratepayers. These are complex transactions, and for a commission to give up future regulatory review and implement the True-up Mechanism on the charges, it is essential to have that assurance.

**Q. GIVEN YOUR EXPERIENCES IN TEXAS, WOULD YOU RECOMMEND THAT THE COMMISSION REQUIRE AN INDEPENDENT FINANCIAL ADVISOR TO PLAY AN ACTIVE ROLE IN CONNECTION WITH THE STRUCTURING, MARKETING, AND PRICING OF STORM RECOVERY BONDS?**

A. Yes.

## OTHER CONDITIONS TO INCLUDE IN A FINANCING ORDER ESTABLISHING A RATEPAYER-BACKED BOND PROGRAM

**Q. IN YOUR OPINION, WHAT OTHER ITEMS SHOULD THE COMMISSION CONSIDER IN DECIDING WHETHER TO APPROVE THIS IRREVOCABLE FINANCING ORDER?**

A. The Commission should also consider how the structuring, marketing and pricing process will be pursued to maintain the public's trust in the integrity of the process itself. For example, potential conflicts of interest between the utility and the Underwriters should be addressed by the Commission on behalf of ratepayers. The terms and conditions of how storm recovery bonds are sold through Underwriters is also important. Many millions of dollars are at stake in the structuring, marketing and pricing of the bonds, so there should be transparency and accountability throughout the process. The Commission is establishing a program and not just overseeing a transaction. It is important that the initial transaction establish an appropriate template and protocols that can be followed in future petitions and transactions. This will make most efficient use of the time of Commissioners and Commission Staff time, as well as help establish in-house expertise. Over time we were able to rely less on outside expertise because of the intense investment we made in the beginning. Leveraging the expertise of a “Bond Team” comprised of DEC and DEP, Commission Staff, the Public Staff, and their independent financial advisors will assist substantially in realizing a Ratepayer-Backed Bond process that successfully achieves the lowest storm recovery charge mandate and the best possible result for ratepayers. This is the first of perhaps many other offerings in the future for storm recovery as Public Staff witness Abramson points out in his testimony. It is a financial tool that the Legislature may authorize for other uses in North Carolina. Establishing the program correctly, with clear standards, oversight and involvement of experts with a fiduciary duty to ratepayers as we did in Texas, is critical to the most efficient and effective use of the financial tool for all affected parties.

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

A. Yes.

BY MR. GRANTMYRE:

Q. Have you prepared a summary of your testimony?

A. I have.

Q. Will you please read that into the record.

A. Yes. Chair Mitchell and Commissioners, it's a pleasure and an honor to be here before you today. The summary of my testimony is as follows:

Utility customers have the potential to realize meaningful savings if specific actions, practices and processes are undertaken through the lifecycle of stages of a Ratepayer-Backed Bond program. The North Carolina General Statute contemplates a lowest storm recovery charge standard, very similar to the statutory provisions in Texas. Adherence to the lowest cost standard results in benefits to the ratepayer, at no cost to the utility. Texas completed three ratepayer-backed bond transactions during my tenure as the commissioner of the Public Utility Commission of Texas for approximately 2.5 billion dollars. These transactions established the baseline for the program. The practices that we undertook resulted in an average ratepayer savings for the three transactions of 23 million nominal dollars and 17 million net present value, as compared to the pricing of other ratepayer-backed bonds during the same time frame. The actions and processes we developed and implemented that resulted in these bonds may be beneficial to the North Carolina Utilities Commission. In this spirit, I offer highlights below of the actions undertaken in Texas that resulted in a superior outcome in terms of transaction cost savings to ratepayers.

Ensuring ratepayer interests are represented at every stage of the transaction. The PUC in Texas took an approach of being actively engaged in implementing the terms, conditions and provisions of each phase of the transaction process. In other words, the structuring of the bond; the marketing of the bond; the pricing of the bond. To engage the utility, the underwritings and investors effectively, the PUC of Texas was supported by the special expertise of its financial advisor. This allowed the Commission to receive timely information, and make decisions in realtime on particular matters. For example, the Public Utility Commission in Texas noticed a hearing within two business days after pricing for the purpose of considering whether to issue a stop order if the Commission was not convinced that the lowest transition bond charge objective in fact had been achieved. The Public Utility Commission of Texas reviewed the marketing and pricing information in realtime so that the PUCT's hands would not be tied as a practical matter. This enabled the Commission to have a framework in which to make decisions on pricing optimally, in a timely way. Ex-post was not satisfactory.

In Texas, the PUCT was a joint decision maker with the sponsoring utility in all matters relating to the structuring, marketing and pricing of the transition bonds. We expect the utility to work in a collaborative basis with the PUCT staff as well as with the PUCT's independent financial advisor to help ensure a successful transaction at the lowest transition bond charges to ratepayers. There is no reason why ratepayer interests and the utilities' interests cannot be aligned in light of the fact that any savings that could benefit ratepayers do not affect what the utilities will receive as part of the securitization amount necessary to recover storm damage costs on behalf of the utility's ratepayers. On the other hand, the interests of underwriters and investors are not aligned with the ratepayers, and therefore it is imperative that the ratepayers' interests be represented at the negotiating table.

Codifying certain provisions in the financing order. The statutory requirements in Texas provided that the structuring and pricing of transition bonds result in the lowest transition bond charges consistent with market conditions. The PUCT went an extra step to require in its financing order that the marketing of the bonds also be incorporated. North Carolina has a statutory provision (N.C. general statutes, at section 62-172(b)(3)b), which directs the North Carolina Utilities Commission, similar to the Texas Commission, to include in its financing orders any other conditions not otherwise inconsistent with this section that the Commission determines are appropriate. Given this authority, the PUCT felt that it was important to insert "marketing" as a function of lowering transition bond charges because the manner in which the bonds would be marketed would have a strong impact on pricing, and ensure lower transition bond charges.

The financing orders in Texas directed the financial advisor to be actively engaged throughout the transition process in order to ensure the greatest opportunity to meet a lowest cost transaction standard.

Examples of the proactive initiatives the independent financial advisor undertook to help us reach our lowest transition charge mandate include: One, insisting that any servicing fees and administration fees in excess of actual incremental costs be rebated or credited to ratepayers; two, identifying any potential conflicts that may arise between the utility, the underwriter and the utility's advisor; three, participating fully in advance in all aspects of structuring, marketing and pricing the transition cost; four, challenging any decision that it believes might not result in the transition bond charges to ratepayers; and five, requiring certifications from the companies, the book running writing underwriters and the PUCT's financial advisor that the structuring, marketing and pricing of the transition bonds in fact resulted in the lowest bond charges consistent with market conditions at the time the transaction priced and the terms of the financing order.

Although the financial advisor, Saber Partners, in this instance is not supporting the Commission, the financial advisor is supporting Public Staff who represents ratepayers. Similarly, the financial advisor in Texas lent its expertise to the

PUCT given that the agency had purview to protect customers of electric services consistent with the public interest.

The Texas financing orders also required the utility to file a detailed set of analyses and representations called an issuance advice letter (see Klein Exhibit-1) about the pricing of the bonds and documenting the benefits of the transaction to ratepayers.

There is no reason why the utilities, the underwriters, the Commission and the interests of the ratepayers cannot have a unity of purpose in striving to reach a lowest storm recovery charge standard. Any savings that inure to ratepayers materializing from an efficient Ratepayer-Backed Bond program do not diminish the securitized costs that the Commission determines is required for storm reparations. Therefore, utility and ratepayer interests are not inherently in disharmony.

Maximizing the chance of a collaborative and collegial process rests on the Commission clarifying that the ultimate decisionmaking authority for all aspects of structuring, marketing, and pricing the proposed bonds rests with a designated member of the Commission. In addition, the Commission should be clearly dedicated to having the day-to-day decisionmaking rest with an ensemble that includes designated Commission Staff, the Public Staff and its respective financial advisors, and the utilities. As a collaborative, this group would represent voices of all interested parties and can, together, help achieve the lowest storm recovery charge mandate through robust and transparent negotiation.

This completes my summary.

MR. GRANTMYRE: The witness is available for cross-examination.

MR. JEFFRIES: Chair Mitchell, this is Jim Jeffries. I will be cross-examining Ms. Klein today.

CROSS EXAMINATION BY MR. JEFFRIES:

Q. Good afternoon, Ms. Klein.

A. Good afternoon.

Q. I want to congratulate you on a varied and impressive resume. I don't know whether to call you lieutenant colonel, counselor or -- I'm not sure what's next. I do have a few questions for you. I don't think anything will be too complicated. I just want to focus on a couple of points of your testimony.

I would like to start off with the discussion of the statutory lowest cost requirement in North Carolina and your testimony about what standard the Commission should apply here. In your testimony -- and I'm referring to page six, line five if my notes are right -- you suggest that the Commission should adopt a lowest storm recovery charge standard when providing for the issuance of storm recovery bonds in this proceeding, is that right?

A. Correct.

Q. And I presume that you are familiar with North Carolina General Statute 62-172 which is the statute that authorizes the securitization transactions we're about today?

A. Yes.

Q. Okay. And we're probably going to make reference to that.

MR. JEFFRIES: So, Chair Mitchell, I would ask that DEC -- what's been premarked as DCDP Cross Exhibit number one be marked for identification, please.

CHAIR MITCHELL: Mr. Jeffries, to the extent that you are asking -- that you're referencing the statutory provision, the Commission will take judicial notice of.

MR. JEFFRIES: I am perfectly happy with that and this document is already in the record in any event.

CHAIR MITCHELL: Correct.

MR. JEFFRIES: As Public Staff Cross exhibit number one or is part of Public Staff Cross-examination Exhibit number one. I'm just mostly concerned that Ms. Klein has a copy of it available to her.

CHAIR MITCHELL: Understood. Ms. Klein, do you have the document available to reference if Mr. Jeffries asks you questions?

THE WITNESS: I do.

MR. JEFFRIES: Okay. Great.

BY MR. JEFFRIES:

Q. As I mentioned, this is the statute that authorizes storm securitization and that statute in section B3, I believe, which is on page five of 14, at least on my version, that section requires that this Commission find in its financing order that the storm recovery bonds -- that the structuring and pricing of the storm recovery bonds reasonably expected to result in the low 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. Do you see that?

A. I do.

Q. Okay. I wanted to focus on the fact that the requirement there, the statutory requirement anyway, is for the Commission to find this as part of their financing order. Do you agree with that?

A. Yes.

Q. Were you listening a little earlier when I was talking to Mr. Heath in response to some of the Commission questions?

A. Yes.

Q. Okay. Did you hear Mr. Heath say that the company's intent was to certify that the structuring pricing of bonds are -- will result in the lowest storm recovery charges consistent with market conditions at the time they are issued?

A. Yes.

Q. Okay. That's essentially what you have asked the Commission to adopt here, right? That standard, at the time the bonds are issued that they're the lowest charges possible?

A. Well, I also heard the clarification about certification before and after.

Q. I'm sorry, what are you referring to?
A. The certification that all actions have been taken in order to reach the lowest.
Q. You're saying that was Mr. Heath's testimony?
A. That's what I understood. The conversation was that there was in the financial order, but then there was certification after.
Q. Right. Right. There's a Commission -- a required Commission finding and the findings in the order, and then Mr. Heath was specifically referencing the fact that the company intends to give essentially the same assurance to the Commission at the time the bonds are issued. I guess my question is, it seems to me that the answer is yes, but I would like to hear your answer. Is that what you are recommending the Commission adopt, that certification at the time the bonds are issued?
A. I am recommending that the Commission adopt language that certifications are made by not just the utility but also by the financial advisor and the underwriter.
Q. Okay. Thank you for that clarification.
Ms. Klein, while you were a member of the PUCT, you were involved in three bond approvals which

you found to be similar to the storm recovery bonds, is that right?

A. That's correct.

Q. And these transactions occurred in the 2001 to 2004 time frame, is that right?

A. Yes, that's correct.

Q. And the Commission hired a consultant to assist in those bond offerings, correct?

A. Correct.

Q. And that consultant worked for the Commission and was the Commission's representative in the bond offering processes, right?

A. Yes.

Q. Okay. As part of your testimony, you provided several of the financing orders that were issued by the Texas Commission in those transactions. And you had certain language, is that right?

A. That's correct.

Q. And was the highlighting intended to indicate those provisions that you considered to be best practices for issuing back bonds?

A. Yes.

Q. Now, at the time that these three bond transactions, you were a member of the PUCT, is that right? I'm sorry, you may have actually been chair. I didn't mean to demote you there.

A. Yes, part of the time I was commissioner and part of the time I was chairman.

Q. Okay. Great. Now, shortly after that, if I understand your resume, you went to work as a consultant to Saber, is that correct?

A. I was an advisor.

Q. So you're independent, you're not an employee, but you do things like you're doing today for Saber capacity as an advisor, is that right?

A. Yes, on occasion.

Q. Okay. Great. On page nine of your testimony you state that the -- a normal incentives to minimize waste and eliminate inefficiencies that are inherent in traditional bond issuances are absent with ratepayer-backed bonds, is that right?

A. Yes.

Q. Okay. But then on page 18 of your testimony, on lines 17 through 21, you also say -- and I believe I heard you say this in your summary today -- that there is no reason why ratepayer interest and company's interests cannot be aligned in light of the fact that any savings that could benefit ratepayers do not affect the amount the utilities will receive as part of the securitized amount.

A. That's correct.

Q. You still agree with it?

A. I do.

Q. Okay. Great. Thank you. You also in your summary recommended that we act in participation in, I guess if you were listening earlier today, being phases two and three of Mr. Creech's example, but I'll refer to it simply as the structuring, marketing and pricing of the ratepayer-backed bonds, that you felt it was important that there be someone representing ratepayer interests in that process, is that right?

A. Correct.

Q. So let's talk about that construct. Would you agree with me that 62-172, NC General Statute 62-172 does not contain any express direction for the Commission or the Public Staff to actively participate in the bond issuance process after the issuing of the financing order?

A. That's correct, as it reads now. Although it does provide a catchall provision that allows the Commission to insert any other condition.

Q. Right. I -- I'm sorry, go ahead.

A. As long as it's consistent with the securitization statute.

Q. Right. Right. But my point is that the statute is -- I understand the argument that subsection B 12 authorizes the Commission to take actions that are not inconsistent with the statute. But you would agree, especially silent on Public Staff or Commission participation after the financing order, correct?

A. Correct.

Q. If the Commission determines to take the company's suggestion that was made in its rebuttal testimony to create a bond team or the Commission was a coequal decision maker on the bond team and was able to look out for ratepayer's interest and observe the structuring, marketing, pricing process, that would be consistent with your recommendations and your testimony, correct right?

A. The ratepayer interest bond team then, yes, it would be. And that would include incorporating some of the recommendations that we have encouraged in my testimony.

Q. Right. What you're saying, I think, is that you agree with me, but you also made some other proposals that I'll characterize as the details about the structuring, marketing, pricing process. And you would think those would be appropriate to include. Is that what you're saying?

A. Yes. That full ratepayer representation would reflect itself incorporating suggestions that I indicate in my testimony and the other witnesses.

Q. Okay. All right. Thank you. And you, of course, have heard Mr. Heath say that they're fine with the mechanism where the Commission is a coequal decision maker member of the bond team? You heard Mr. Heath say that?

A. I did.

Q. And you also heard Mr. Heath say that the Company didn't have a problem if the Public Staff was an advisor to that process and that the Public Staff's consultants were an advisor to that process. Where they drew the line what was sort of the difficulty they were struggling with was carrying the Public Staff across the line to the status of being a coequal decision maker, right? That's the hang-up?

A. Correct. That's the hang-up and also interaction with third parties.

Q. Thank you for reminding me of that. On page 23 of your testimony you site to North Carolina General

Statute 6215 as support for the idea that the Public Staff should be included on the bond team?

A. Yes.

Q. Do you have a copy of that statute handy?

A. I think I can get it.

Q. Let me know when you've got it, please.

(Pause.)

A. Okay. I have it.

Q. Ready? Okay. Great. So subsection D of 6215 describes the duties and responsibilities of the Public Staff, correct?

A. Correct.

Q. Okay. And then there's 12 subsections under section D that talk about the Public Staff's responsibilities and duties to undertake certain actions that -- and I don't know that there's any disagreement about this, but any actions that aren't particularly relevant to what we're about today. But subsection 12, which states that when deemed necessary by the executive director in the interest of the using consuming public, advise the Commission with respect to securities regulations and transactions pursuant to the provisions of Article A of this chapter. And it's your understanding that that is the provision that the

Public Staff is leaning on to say that they have an opportunity or an obligation or right to participate in the structuring, marketing and pricing of the bonds, is that right?

A. Yes.

Q. Okay. The only way I can make that make sense, and maybe you can illuminate on this, is -- I mean, clearly there's nothing in subsection 12 that says and the Public Staff can participate as a coequal decision maker on issuances by public utilities. You'd agree with me that it does not say that, right?

A. Yes.

Q. Okay. And there's no other -- let me ask you this. Are you aware of any other statute -- and I'll make the exception for the one we have already identified, 62-172 12, which is where you based the argument that basically the clean-up clause, the ability of the Commission to make additional orders that aren't inconsistent with 62-172, other than that provision which is what the Public Staff is hanging its hat on, in addition to 62-15 D12, are you aware of any other provision of North Carolina law or Commission regulations that would support the Public Staff as a consumer advocate participating in a securities issuance by a public utility, or in this case a special purpose entity owned by the public utility?

A. I'm not.

Q. Okay.

MR. JEFFRIES: I think that's all the questions I have for Ms. Klein, Chair Mitchell.

CHAIR MITCHELL: All right. Mr. Grantmyre, redirect.

MR. GRANTMYRE: Yes, I have several questions.

REDIRECT EXAMINATION BY MR. GRANTMYRE:

Q. Ms. Klein, do you still have GS 62-15 in front of you?

A. Yes, I do.

Q. Now, I refer you to Section D. Do you see section D on the first page of that statute?

A. Yes, I do.

Q. And do you see it says -- D begins, it shall be the duty and responsibility of the Public Staff to. You see that, don't you?

A. I do see it.

Q. Now, in Texas you didn't have a Public Staff in the Commission, did you?

A. No, we did not.

Q. And really in the cases before the Texas Commission, the Commission staff would file testimony on behalf of customers or in the customers' interest on occasion, is that correct?

A. That's correct.

Q. Now, on the statute it also says under three, D3 -- can you please read what D3 says, where it says it shall be the duty and responsibility of the Public Staff to. Number three, can you read that? Intervene on behalf?

A. Yes. It says intervene on behalf of the using and consuming public in all Commission proceedings affecting the rates or service of any public utility.

Q. Now, these storm security charges are really part of the rates, they may not be part of the base rates but the customers are paying this as part of their utility bill, isn't that correct?

A. That's correct.

Q. So to the average customer, this is rates, wouldn't you agree, to the uninformed customer like Bill Grantmyer it may be rates?

A. I would agree.

Q. Now, do you feel like this language is very strong? It doesn't say that Public Staff may intervene. It says the public shall intervene. Do you understand that strong language?

A. Yes, I believe that is a very unequivocal directive.

Q. Now, in your Texas proceeding you said the bond team, including the Commission's financial advisor, was able to communicate with third parties, is that correct?

A. Yes. They were at the table communicating and negotiating with third parties in every aspect, in every meeting because the Commission acting through its financial advisor.

MR. JEFFRIES: Excuse me, Ms. Klein. I would object to this question. I did not ask any questions concerning the role of the Texas Public Utility Commission staff. And as far as I know, redirect is intended to be limited to the scope of cross.

MR. GRANTMYRE: They brought up the question about the activities with the third parties or she did in her answer, and we have the right to follow up on that.

CHAIR MITCHELL: I'm going to overrule

the objection, Mr. Grantmyre.

BY MR. GRANTMYRE:

Q. Did they have any -- so they did have interaction with third parties. Who would be the third parties that they interacted with?

A. That would be investors, and I'm sure there were others in addition to investors that they had to negotiate with and communicate with. Basically any third party that the utility would find themselves interacting with as well in this process.

Q. And when you were the chair of the Texas Commission and a commissioner, these three ratepayer-backed bond issues, was this a new process for the Texas Commission?

A. When I was commissioner and chair it wasn't. There were some previous securitizations that were already completed in which the financial advisor was also used.

Q. You were asked on the bond team. Can you please give a brief summary of why you feel the ratepayers need a participant in the bond team in addition to the Commission, the appointed commissioner or the Commission staff?

MR. JEFFRIES: Objection, Chair

Mitchell. Again, I asked about the Commission's participation and whether the Commission's participation satisfied the results.

MR. GRANTMYRE: He asked about the composition of the bond team and we have the right to follow up on that as to what her position is as to the composition of the bond team and why.

CHAIR MITCHELL: All right. One more time, I'll overrule the objection. But, Mr. Grantmyre, stick to redirect. Tailor your questions to questions that the witness was asked on cross-examination.

MR. GRANTMYRE: This is my last question. If I can remember it, I'll ask it again.

BY MR. GRANTMYRE:

Q. Would you please summarize why you believe it is necessary to have the ratepayers have a member of the bond team with decisionmaking authority?

A. Yes. Because given their mandate to be a part of the proceedings of the Commission representing ratepayers that that voice needs to be at the table during these processes, especially to incorporate and make that voice equal with, you know, those entities that are on the other side that are not representing the ratepayer, like the underwriters, for example. Or that have other conflicting interests like the utility.

MR. GRANTMYRE: Thank you. I have no further questions.

CHAIR MITCHELL: All right. We will entertain questions from commissioners. Start with Commissioner Brown-Bland?

COMMISSIONER BROWN-BLAND: No questions.

CHAIR MITCHELL: Commissioner Gray?

COMMISSIONER GRAY: I have no questions for this witness.

CHAIR MITCHELL: Commissioner Clodfelter?

COMMISSIONER CLODFELTER: Thank you. No questions for Mr. Clodfelter.

CHAIR MITCHELL: Commissioner Duffley?

COMMISSIONER DUFFLEY: No questions.

CHAIR MITCHELL: Commissioner Hughes?

COMMISSIONER HUGHES: No questions.

CHAIR MITCHELL: Commissioner McKissick?

COMMISSIONER McKISSICK: No questions.

EXAMINATION BY CHAIR MITCHELL:

Q. Ms. Klein, I do have several questions for you. Can you help us understand who is or what is the

Texas office of Public Utility Counsel and what role did that organization play, if any, in the securitization proceedings?

A. Yes. They are an office that has a separate agency, not under the jurisdiction of the Commission. And they do represent residential and small commercial customers and they are interveners.

Q. Okay. And so did that organization play a role in the proceedings or intervene in the securitization proceedings?

A. Yes, they were interveners in the proceedings.

Q. Were they a member of the bond team in any capacity?

A. No, they were not.

Q. Okay.

A. And they were not because -- we already had ratepayer interests represented in the Commission.

Q. Okay. Just explain for me what you mean when you say that. Help me understand specifically what you're saying there, that you already had ratepayer interest represented in the Commission.

A. Because the Commission is -- the utility Commission in Texas is authorized to represent ratepayers and not just regulate utilities, but also represent ratepayers as well.

Q. Okay. Do you understand of --

A. As far as our interest goes.

Q. I apologize for interrupting you. You may need to restate your response for the court reporter's purposes.

A. And so, you know, they don't just regulate utilities. They also represent the public interest, which is ratepayers are part of that public interest.

Q. Okay. Do you understand that the statutory authority of the Public Utility Commission of Texas to be different from than that of the North Carolina Public Utilities Commission?

A. That's correct.

Q. Okay.

CHAIR MITCHELL: I have nothing further for you, Ms. Klein. Thank you. Questions on Commissioner's questions? From the company?

MR. JEFFRIES: No further questions, Chair.

CHAIR MITCHELL: Mr. Grantmyre?

MR. GRANTMYRE: Public Staff has none, Chair Mitchell.

CHAIR MITCHELL: Thank you, Ms. Klein. Thank you very much for your time today. We have come to the end of your testimony. You may step down and counsel will entertain motions.

MR. GRANTMYRE: I move that her testimony be admitted into evidence and exhibits one through four to her testimony be admitted into evidence.

CHAIR MITCHELL: All right. Hearing no objection, the motion is allowed. All right. Ms. Klein, thank you very much.

THE WITNESS: Thank you.

MR. GRANTMYRE: Thank you.

(Klein Exhibits 1 through 4 were admitted into evidence.)

CHAIR MITCHELL: All right. Mr. Robinson, we are back with you.

MR. ROBINSON: Thank you, Chair Mitchell. We have Mr. Charles Atkins who is up next and that will be Jim.

CHAIR MITCHELL: All right. Let's see. Mr. Atkins, there you are.

CHARLES N. ATKINS, III,

having first been duly affirmed, was examined and testified as follows:

CHAIR MITCHELL: All right. Thank you. Mr. Jeffries, you may proceed.

MR. JEFFRIES: Thank you, Chair Mitchell. I'm going to talk to Mr. Robinson about the allocation here today after the hearing is over, but I know everyone is probably getting tired of hearing me talk so we'll try and get through this as quickly as we can.

DIRECT EXAMINATION BY MR. JEFFRIES:

Q. Mr. Atkins, could you state your name and business address for the record, please?

A. Yes. I am Charles N. Atkins and my business address is 170 East End Avenue in New York, New York. Zip is 10128.

Q. Where do you work, Mr. Atkins?

A. I work at Atkins Capital Strategies and I serve as the chief executive officer.

Q. Okay. Are you the same Charles Atkins that prefiled direct testimony in this proceeding on October 26, 2020 consisting of 60 pages and Atkins exhibits one through four?

A. I am, yes.

Q. Was that testimony and were those exhibits prepared by you or under your direction?

A. Yes, sir. Yes, sir.

Q. Do you have any corrections to that testimony or those exhibits?

A. I don't, no.

Q. Mr. Atkins, if I asked you the same questions as are set forth in prefiled direct testimony while you're on the stand today, would your answers be the same?

A. Yes, sir.

Q. And are you also the Charles Atkins that prefiled rebuttal testimony in this docket on January 11, 2021 consisting of 17 pages and Atkins rebuttal Exhibit-1?

A. Yes, sir.

Q. And was that testimony and that exhibit prepared by you or under your direction?

A. Yes, sir.

Q. Do you have any corrections to that testimony or exhibits?

A. I don't.

Q. And if I asked you questions that are set forth in your prefiled rebuttal while you're on the stand today, would your answers be the same?

A. Yes, sir.
Q. All right.
MR. JEFFRIES: Chair Mitchell, move that Mr. Atkins's prefiled direct and rebuttal testimony be entered into the record as if given orally from the stand.
CHAIR MITCHELL: Hearing no objection to your motion, the prefiled direct and rebuttal testimonies of Mr. Atkins will be copied into the record as if delivered oral from the stand.
MR. JEFFRIES: And we would also request that Mr. Atkins's exhibits, direct and rebuttal exhibits be identified as premarked.
CHAIR MITCHELL: All right. And the exhibits to Mr. Atkins's prefiled testimony will be identified as they were when prefiled.
MR. JEFFRIES: Thank you, Chair Mitchell.
(Whereupon, the prefiled direct and rebuttal testimony of Charles N. Atkins, III was copied into the record as if given orally from the stand.)
(Atkins Exhibits 1-4 and Rebuttal Exhibit 1 was identified as marked when prefiled.)

**BEFORE THE NORTH CAROLINA UTILITIES COMMISSION**

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

| | | |
|---|---|---|
| In the Matter of:<br><br>Joint Petition of Duke Energy Carolinas, LLC and Duke Energy Progress, LLC for Issuance of Storm Recovery Financing Orders | )<br>)<br>)<br>)<br>) | **DIRECT TESTIMONY OF CHARLES N. ATKINS II FOR DUKE ENERGY CAROLINAS, LLC AND DUKE ENERGY PROGRESS, LLC** |

**INDEX TO THE DIRECT TESTIMONY OF CHARLES N. ATKINS II**

**FOR**
**DUKE ENERGY CAROLINAS, LLC AND DUKE ENERGY PROGRESS, LLC**



| | |
|---|---|
| Atkins Exhibit 1 | Professional Resume of Charles N. Atkins II |
| Atkins Exhibit 2 | Internal Revenue Service Revenue Procedure 2005-62 |
| Atkins Exhibit 3 | A list of utility securitization transactions since 1997 |
| Atkins Exhibit 4 | Preliminary Transaction Structures |

## I. INTRODUCTION

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

A. My name is Charles N. Atkins II. My business address is 170 East End Avenue, New York, New York 10128.

**Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?**

A. I am Chief Executive Officer of Atkins Capital Strategies LLC, based in New York City.

**Q. PLEASE BRIEFLY DESCRIBE YOUR EDUCATIONAL BACKGROUND AND PROFESSIONAL EXPERIENCE.**

A. I am a graduate of Harvard Law School, with a Juris Doctor degree. I am also a graduate of Howard University's College of Arts and Sciences with a Bachelor of Arts degree in Political Science, with minor concentrations in Economics, Mathematics and Sociology (Honors Program, Magna Cum Laude, Phi Beta Kappa).

My relevant professional experience includes 23 years of structured finance investment banking at Morgan Stanley, where I focused on corporate structured finance and the securitization of consumer, operating and new assets. I served as an independent consultant to utilities, financial sponsors and other financial institutions as CEO of Atkins Capital Strategies LLC, from 2013 to 2017. I was a Senior Advisor at Guggenheim Securities, LLC from 2017 through August 2020. I have been heavily involved in utility securitizations and played a lead banking role in the first utility stranded cost securitization, which was the $2.9 billion transaction for Pacific Gas and Electric in 1997. At

Morgan Stanley, and as an independent consultant, I served as an advisor to utilities or as the senior Morgan Stanley banker where Morgan Stanley served as a lead or joint lead underwriter for 25 utility securitization bond issues, plus two utility ring-fencing reorganization transactions totaling more than $18.8 billion. I provided testimony as an expert witness on behalf of utilities before regulatory commissions in Arkansas, Louisiana, Maryland, and Texas.

Recently, during 2019-2020 as a Senior Advisor to Guggenheim Securities, I advised Public Service Company of New Mexico ("PNM"), a subsidiary of PNM Resources, in connection with its application before the New Mexico Public Regulation Commission for a securitization financing order. PNM requested a financing order to authorize the issuance of energy transition bonds for the recovery of certain costs associated with the abandonment of the PNM investment in the San Juan coal-fired generation facility. I provided written testimony and interrogatory responses, as well as oral testimony before the New Mexico Public Regulation Commission. The requested financing order was approved on April 1, 2020. A copy of my professional resume is attached as Atkins Exhibit 1.

**Q. DO YOU POSSESS ANY PROFESSIONAL LICENSES RELATED TO THE SECURITIES INDUSTRY?**

A. Yes. I am Series 7 (General Securities Representative Qualification) qualified by the Financial Industry Regulatory Authority, which allows an individual to solicit, purchase, or sell all securities products, including asset-backed securities. I am also Series 79 (Investment Banking Representative) qualified, which allows an individual to advise on and facilitate debt and equity offerings (public offerings or private placements), mergers and acquisitions, tender offers, financial restructurings, asset sales, divestitures, corporate reorganizations and business combination transactions.

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

A. I am testifying on behalf of Duke Energy Carolinas, LLC ("DEC") and Duke Energy Progress, LLC ("DEP") (collectively, the "Companies").

**Q. HAVE YOU PREVIOUSLY TESTIFIED BEFORE THE NORTH CAROLINA UTILITIES COMMISSION ("COMMISSION")?**

A. No.

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

A. The purpose of my testimony is to:

1. Provide background information on the use of utility securitization in other jurisdictions ("utility securitization" is a generic term used to refer to securitizations for a number of different recovery purposes; some of the names used include rate reduction bonds, stranded cost bonds, storm recovery bonds, system restoration bonds, and restructuring bonds, among other names); as well as discuss some of the basic elements of the proposed storm recovery bonds;
2. Present a proposed preliminary storm recovery bond issuance structure and discuss certain structuring considerations; and

3. Discuss several of the key commercial terms of proposed Storm recovery bonds that DEC and DEP expect will be required for a successful transaction, as well as key provisions of the proposed Financing Order.

**Q. ARE YOU SPONSORING ANY EXHIBITS WITH YOUR DIRECT TESITMONY?**

A. Yes. I am sponsoring the following exhibits described below and attached to my testimony:

- Atkins Exhibit 1: Professional resume of Charles N. Atkins II
- Atkins Exhibit 2: Internal Revenue Service Revenue Procedure 2005-62
- Atkins Exhibit 3: A list of utility securitization transactions since 1997
- Atkins Exhibit 4: Preliminary transaction structure cash flows

Each of these exhibits were prepared under my direction and control, and to the best of my knowledge all factual matters contained therein are true and accurate.

**Q. PLEASE SUMMARIZE YOUR TESTIMONY IN THIS PROCEEDING.**

A. Pursuant to N.C. Gen. Stat. § 62-172, an Act to Permit the Financing of Certain Storm Recovery Costs (the "Securitization Statute"), DEC and DEP are submitting a Joint Petition for Financing Orders ("Joint Petition") for the approval of separate Financing Orders authorizing the issuance of storm recovery bonds to recover certain storm recovery costs and related upfront financing costs, associated with the aftermath of Hurricanes Florence, Dorian and Michael, and Winter Storm Diego (the "Storms"). Accordingly, my testimony provides background about, and makes recommendations for, the Financing Orders proposed by the Companies.

Specifically, my testimony describes how the securitizations are proposed to be designed to provide quantifiable benefits to the customers of DEC and DEP, and how the recommended structures and the market-clearing pricing process 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 consistent with the terms of the Financing Orders.

**Q. PLEASE ELABORATE FURTHER ON THE GOAL OF UTILITY SECURITIZATIONS AND HOW YOUR RECOMMENDATIONS HELP TO ACHIEVE THIS GOAL.**

A. Before I discuss the securitization process in detail, I review here (1) the principal goal of utility securitizations, (2) how these securitizations differ from utility corporate debt and other structured debt, and (3) why the issuance by the Commission of financing orders that are consistent with the letter and spirit of the Securitization Statute is critical to achieve the goal of utility securitizations – to deliver significant savings to customers.

**Significant customer savings.** As reflected in Atkins Exhibit 3, securitization has been used by utilities 66 times since the mid-1990s to recover authorized costs in a manner designed to produce significant customer savings. With the appropriate statutory framework and a carefully crafted financing order, securitizations benefit from a significantly lower cost of capital compared to traditional investor-owned utility rate mechanisms. While traditional rate mechanisms set customer rates based upon a regulatory-approved weighted cost of capital, including an average corporate debt rate along with an allowed return on 50 percent or more equity capital in the calculation, utility securitization customer charges are based upon a capital cost comprised of 99.5 percent AAA-rated debt and 0.5 percent equity. In some cases, customer charges are further mitigated through extending the securitization payment period longer than the recovery period under a traditional ratemaking approach.

**Distinct from utility unsecured and first mortgage debt as well as most structured debt.** Utility securitizations are quite different from traditional utility debt offerings. Unsecured utility corporate debt offerings are full recourse obligations of the utility. First mortgage debt offerings are also full recourse to the utility with the added security of a first lien on tangible utility property. In contrast, utility securitizations are non-recourse to the corporate credit of the utility.

Most structured debt is also non-recourse to the sponsor of the transaction, but holds tangible property, loan or revenue-producing contract assets as collateral that is legally isolated from the sponsor's bankruptcy risk, providing security for timely payment of the debt. Such structured debt also typically has what is called "overcollateralization." Overcollateralization means that an incremental amount of collateral is pledged to the debt to provide extra security if the pledged assets do not perform as expected. Another feature of overcollateralization consists of the pledged collateral generating an extra amount of revenues so that there is excess coverage of debt service, called "excess debt service coverage." Some BBB-rated investment grade structured debt transactions have debt service coverage of 1.25 to 1.75 times debt service or more. Rating agency stress scenarios determine how much overcollateralization and debt service coverage is required for a particular rating. It is important to note, that higher ratings for specific structured debt issues, such as AA or AAA, if attainable at all, typically require high quality collateral, and overcollateralization and/or debt service coverage that is significantly higher than the coverage levels mentioned above for BBB-rated investment grade debt. By contrast, while utility securitizations have the intangible securitization property rights as collateral legally isolated from the utility like structured debt, the mandatory true-up mechanism, which adjusts customer charges in amounts required to ensure debt service and ongoing financing costs are paid as scheduled, along with other features work together to produce this non-recourse security that is rated AAA, and at the same time only has a debt service coverage targeted to be 1.0 times. This combination of AAA equivalent ratings and the lack of any excess debt service coverage is unique to this class of structured securities. This extremely low debt service coverage further reduces the required amount of customer charges, enhancing customer savings. However, the low debt service coverage also increases rating agency and investor focus on the provisions of the financing orders, because investors do not have the security of any material overcollateralization or excess debt service coverage.

**The Commission's Financing Orders are critical.** For an investor-owned utility to recover authorized costs in a manner to result in significant customer savings through securitization, the proper statutory framework is required, coupled with a Commission-issued financing order that is consistent with the letter and the spirit of the authorizing statute. The North Carolina Securitization Statute has the proper framework authorizing these storm recovery securitizations and outlines the necessary statutory requirements for securitization financing orders. DEC and DEP, through the Joint Petition and accompanying testimony, propose Financing Orders that meet the requirements for the storm recovery bonds to achieve AAA ratings and broad acceptance by investors.

My testimony provides an overview of the utility securitization process, the proposed transaction structures, as well as several required Financing Order elements. But at a high level, it is the Financing Orders that leads to the creation of the intangible property that serves as collateral for the securitizations. The Financing Orders must be crafted in a manner to enable the storm recovery bonds to achieve AAA equivalent ratings, even though the transactions will be structured with essentially only 1.0 times debt service coverage. Moreover, for investors to accept these bonds with virtually no excess debt service coverage or overcollateralization, the rating agencies and investors need to be persuaded that over the life of the transactions, there is little risk of political and regulatory interference from the legislature and/or a subsequent Commission that may delay payments on the bonds. The way the Financing Orders are crafted can serve as important evidence that such risk is sufficiently minimized in these transactions, particularly since these will be the first securitization Financing Orders issued by the North Carolina Utilities Commission. The structure recommended in the Companies' Joint Petition, corresponding testimony and exhibits is designed to result in financing orders that satisfy these important requirements.

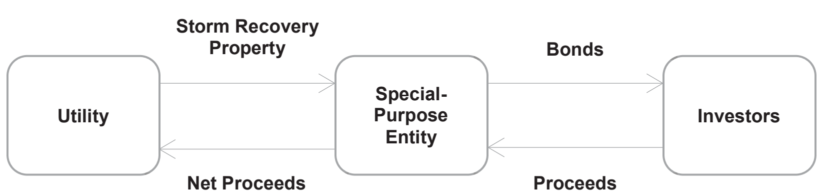
## II. SECURITIZATION BACKGROUND

**Q. PLEASE PROVIDE A BASIC DESCRIPTION OF SECURITIZATION.**

A. In general, securitization is the process in which an owner of a cash flow-generating asset sells the asset for an upfront payment, done in a manner that legally isolates (or de-links) the cash flow-generating asset from the credit profile of the owner/seller. The sale process is intended to protect investors from any changes in credit circumstances, or even the bankruptcy, of the entity that sold the asset. Therefore, the "credit" of a securitization is the ability of the legally isolated asset to produce a set of payments (or cash flows) for investors, who purchased a securitized interest in the asset. Fixed income debt securities collateralized by the legally isolated asset are issued to investors, and those investors rely solely on the legally isolated asset and associated cash flows to pay interest and principal on the issued debt securities. The debt securities are non-recourse to the selling entity.

In the context of utility securitization, the underlying cash flow-generating asset is an intangible property right authorized by state legislation and created pursuant to a financing order. This property right includes the right to impose upon the utility's current and future customers the charges required to pay the interest, principal and other ongoing financing costs associated with the debt securities issued in the securitization on a timely basis, as scheduled. This property right is also referred to as the collateral for the transaction. The utility sells the property right to a newly established, special-purpose entity ("SPE") which, as its name implies, functionally does nothing other than purchase the collateral and issue bonds to investors to fund that purchase. The conveyance of the property right from the utility to the SPE is also referred to as a "true sale," as it legally isolates the collateral from the seller of that collateral. A true sale of the collateral supports the "bankruptcy-remoteness" of the SPE and the securitization debt.

To have the funds needed to purchase the collateral, the SPE, directly or indirectly issues debt securities to investors, collateralized by the property right it purchases from the seller. In exchange for the issued debt, investors pay an upfront purchase price, which is passed through to the SPE back to the utility. Figure A, below, is a simplified indicative schematic of the transaction closing mechanics described above:




In addition to the essential structure described above, the securitization process also includes another key component: ongoing collections of the cash generated by the collateral. Here, the utility and a trustee ("Trustee," typically a commercial bank experienced with securitization trust services) play important roles. The utility will continue to perform its routine billing and collecting functions. In the context of securitization, this function is referred to as servicing, and the utility takes on the role as the servicer. Therefore, in the proposed transaction, DEC and DEP will each act as a servicer for its SPE. In addition to its routine billing and collecting functions, as servicer, the utility will also perform certain reporting duties with respect to the amount of money collected. The servicer will perform these functions for the SPE pursuant to a contractual arrangement known as the servicing agreement.

The Trustee also plays an important role in the safekeeping of the ongoing collections and distributing them to investors. After receiving its collections, the servicer remits the monies to the SPE trust account held at the Trustee, which maintains those monies until it periodically remits them to investors according to a pre-determined set of payment priorities (the "waterfall") and schedule (typically semi-annually in utility securitizations). The Trustee serves as a representative of the bondholding investors and ensures that their rights are protected in accordance with the terms of the transaction.

**Q. WHAT IS THE VOLUME OF UTILITY SECURITIZATIONS THAT HAVE BEEN TRANSACTED TO DATE, AND WHO ARE THE TYPICAL INVESTORS?**

A. Utility securitizations are structured based upon well-established legal and rating criteria and have been issued since 1997. These securitizations may have specific requirements for tax purposes, please see Atkins Exhibit 2. According to public records, including Securities and Exchange Commission ("SEC") registration filings, since 1997 to date, there have been 66 securitization transactions by or on behalf of investor-owned utilities, totaling in excess of $50 billion. These transactions are well understood by many investors, and types of investors that have participated in utility securitizations include banks, institutional and retail trust funds, money managers, investment advisors, pension funds, insurance companies, securities lenders and state trust funds. I attach a list of utility securitization transactions as Atkins Exhibit 3.

**Q. HAVE OTHER COLLATERAL TYPES BEEN SECURITIZED IN A SIMILAR MANNER?**

A. Yes, the market for securitized products or asset-backed securities ("ABS") is large. Examples of other collateral types include certain consumer-related cash flows, such as credit card receivables, auto loans, auto leases, and student loans. During 2019, an estimated $297 billion of ABS was issued in the United States, and as of the end of September 2020, the year-to-date issuance for the U.S. ABS market was over $172 billion (Source: Asset-Back Alert Database). The investors who primarily purchase utility securitizations generally come from both the ABS market and the corporate debt market.

**Q PLEASE DESCRIBE THE FORMATION OF THE SPE THAT WILL ISSUE THE STORM RECOVERY BONDS.**

A. The DEC and DEP securitization transactions are generally expected to follow a process similar to the process for utility securitizations described above. DEC and DEP will form SPEs as Delaware LLCs, and each SPE is a wholly-owned subsidiary of DEC and DEP, respectively. Each SPE's LLC Agreement will contain provisions designed to ensure that such SPE will be a bankruptcy-remote limited purpose entity. When I refer to "bankruptcy-remote," I mean that the SPE is structured so that in the unlikely event of a DEC, DEP or Duke Energy Corporation ("Duke Energy") bankruptcy, that SPE would not be consolidated with other Duke Energy entities, would not be included in Duke Energy's bankruptcy estate, and the payment of the securitization debt service would not be "stayed" or stopped during the bankruptcy process. Importantly, each SPE is structured to operate independently, requiring that fees paid to third-parties providing services to the SPE, including DEC and DEP as Servicers and Administrators, are set on an arms-length basis. These provisions supporting the bankruptcy-remote nature of each SPE are critical to achieving the desired "AAA" equivalent ratings for the storm recovery bonds. In addition, each SPE will be able to issue more than one series of storm recovery bonds, in the event subsequent financing orders are approved and issued, and the Companies choose to do so. An illustrative draft form of each SPE LLC Agreement has been included as exhibits to the testimony of the Companies' witness Thomas J. Heath, Jr.

**Q. WHAT MAKES UP THE "STORM RECOVERY PROPERTY" THAT THE COMPANY SELLS TO THE SPE?**

A. The storm recovery property that is created pursuant to the Financing Order and sold to the SPE is the right to impose, bill, charge, collect and receive a certain nonbypassable charge, the storm recovery charge, paid by all existing or future retail customers receiving transmission or distribution service, or both, from DEC or DEP, as applicable, or their respective successors or assignees under Commission-approved rate schedules or under special contracts, even if a customer elects to purchase electricity from an alternative supplier, applying the applicable customer allocations, in amounts necessary to pay principal and interest on the storm recovery bonds, as well as other amounts, timely and in full. Included in this property right is the requirement, over the full life of the transaction, to adjust the amount of the storm recovery charges owed by each Company's retail electric customers, based principally upon variations in energy demand, energy consumption and the number of each Company's customers, to ensure that the amounts collected are sufficient to pay all amounts owed with respect to the storm recovery bonds, on a timely basis as scheduled. This process is referred to as the "true-up" adjustment mechanism.

**Q. PLEASE FURTHER DESCRIBE THE SALE OF THE STORM RECOVERY PROPERTY BY THE COMPANIES TO THE SPES.**

A. Pursuant to the purchase and sale agreement, in consideration for the payment by each SPE of the purchase price for the storm recovery property, the Company will sell, assign, transfer and convey all rights, title and interest of the Company in, to and under the storm recovery property to the SPE. An illustrative draft of the storm recovery property purchase and sale agreement (the "Purchase and Sale Agreement") between DEC and DEP and the SPEs is attached to the testimony of witness Heath, as Heath Exhibit 2a. The Purchase and Sale Agreement will provide that such sale, transfer, assignment and conveyance is expressly stated to be an absolute transfer and true sale. Pursuant to N.C. Gen. Stat. § 62-172(e)(3)a., if the purchase and sale agreement expressly so states, any sale, assignment or other transfer of storm recovery property shall be an absolute transfer and true sale of, and not a pledge of or secured transaction relating to, the seller's right, title and interest in, to and under the storm recovery property. As I mentioned previously, this "true sale" treatment is an essential component of legally isolating the storm recovery property collateral from the bankruptcy risk of DEC and DEP and achieving "AAA" or equivalent ratings for the storm recovery bonds.

**Q. PLEASE DESCRIBE THE STORM RECOVERY PROPERTY AND STORM RECOVERY CHARGES SUPPORTING THE STORM RECOVERY BONDS.**

A. "Storm recovery property" is defined in N.C. Gen. Stat. § 62-172(a)(15) as (i) all rights and interests of a public utility, such as DEC and DEP, or successor or assignee of the public utility under a financing order (*i.e.* the SPE), including the right to impose, bill, charge, collect and receive storm recovery charges authorized under the Financing Orders and to obtain periodic adjustments to such charges as provided in the Financing Orders and (ii) all revenues, collections, claims, rights to payments, payments, money or proceeds arising from the rights and interests specified in the Financing Orders, regardless of whether such revenues, collections, claims, rights to payment, payments, money or proceeds are imposed, billed, received, collected or maintained together with or commingled with other revenues, collections, rights to payment, payments, money, or proceeds.

As set forth in N.C. Gen. Stat. § 62-172(a)(13), the storm recovery charges are nonbypassable charges (i) imposed on and part of all retail customer bills, (ii) collected by a public utility or its successors or assignees, or a collection agent, in full, separate and apart from the public utility's base rates, and (iii) paid by all existing or future retail customers receiving transmission or distribution service, or both, from the public utility or its successors or assignees under Commission-approved rate schedules or under special contracts, even if a customer elects to purchase electricity from an alternative electricity supplier following a fundamental change in regulation of public utilities in North Carolina.

The storm recovery charges will be designed to provide for amounts sufficient to pay the principal of and interest on the storm recovery bonds as scheduled and in full, as well as other on-going financing costs associated with the storm recovery bonds. Included in the storm recovery property is the right to the true-up adjustment mechanism ("True-Up Mechanism"), which is a requirement to adjust the amount of the storm recovery charges owed by customers to ensure that the amounts actually collected are sufficient to pay all amounts owed with respect to the storm recovery bonds as scheduled and in full, including on-going financing costs. The process for implementing the True-Up Mechanism is described in the testimony of witness Shana W. Angers.

**Q. HOW ARE STORM RECOVERY BONDS DIFFERENT FROM UTILITY UNSECURED CORPORATE BONDS?**

A. The proposed storm recovery bonds are different from utility unsecured bonds because these proposed bonds are non-recourse to the Companies. Utility unsecured and first mortgage bonds are fully recourse to the Companies. In addition, the storm recovery bonds will be structured to amortize with scheduled principal payments through specific points in time prior to the rated legal maturity date of the storm recovery bonds. These points in time are referred to as the expected or scheduled maturities for each of the multiple tranches of bonds issued in the transaction, as further described below. Amortizing, or sinking-fund, structures are distinct from traditional utility corporate bonds, which generally have only a single “bullet” principal payment at the bond maturity date. Another difference is that the storm recovery bonds will be structured with a time gap between each tranche’s scheduled final payment and the rated legal maturity of that tranche. This time gap, sometimes called a “maturity cushion,” provides extra time to pay the outstanding principal amount of the tranche in full in the event that unforeseen circumstances such as significant declines from either the forecasted energy demand, forecasted consumption, and/or the forecasted number of customers, cause a material decrease in storm recovery charge collections.

**Q. ARE THERE "OTHER AMOUNTS" BEYOND DEBT SERVICE REQUIRED TO BE COLLECTED IN CONNECTION WITH THE STORM RECOVERY BONDS?**

A. There will be other amounts in addition to the bond principal and interest that will be payable on an ongoing basis over the life of the transaction. These costs, which are required on-going financing costs, include, but are not limited to, servicing fees, trustee fees, rating agency surveillance fees, legal fees, administrative fees, audit fees, other operating expenses and credit enhancement expenses (if any). Generally, these amounts are SPE expenses that are required to keep the transaction working as designed, without reliance on DEC and DEP or any other source of funds. It is essential to the SPE's status as a bankruptcy-remote entity for the transaction structure to provide for the full payment of on-going financing costs. These anticipated fees and expenses are estimated in the testimony of witness Heath and included as Heath Exhibit 1.

**Q. IN YOUR EXPERIENCE, ARE THE COSTS ESTIMATED BY DEC AND DEP WITHIN THE RANGE OF COSTS YOU HAVE PREVIOUSLY SEEN FOR SIMILAR EXPENSES?**

A. Yes. I have provided input on and reviewed the preliminary expense estimates provided by witness Heath, as well as the supporting examples provided from previous transactions. While the Companies' proposed securitization is not expected to occur until 2021, and costs may change, these estimated costs are within the ranges found in other utility securitization transactions.

**Q. IN ADDITION TO THE STORM RECOVERY PROPERTY, ARE THERE ANY OTHER COMPONENTS OF THE COLLATERAL FOR THIS TRANSACTION?**

A. Yes. The collateral for the transaction includes other components in addition to the storm recovery property. However, that property right is the principal asset pledged as collateral. Pursuant to the Indenture, the other collateral includes a collection account, which is established by the SPE as a trust account to be held by the Trustee to ensure the scheduled payment of principal, interest and other costs associated with the storm recovery bonds are paid in full and on a timely basis. The collection account, in turn, is comprised of the three subaccounts:

- the general subaccount;
- the capital subaccount; and
- the excess funds subaccount.

The collateral also consists of the SPE's rights under certain agreements it enters into as part of the transaction, including the purchase and sale agreement and the servicing agreement.

**Q. PLEASE DESCRIBE THE SUBACCOUNTS OF THE COLLECTION ACCOUNT REFERRED TO ABOVE.**

A. The general subaccount is the subaccount in which the Trustee deposits storm recovery charge remittances it receives from the servicer. Monies in this subaccount will be applied by the Trustee on a periodic basis to make payments according to a prescribed order (or "waterfall"), which generally includes the payment of SPE expenses required to maintain the operations of the transaction, then interest on the storm recovery bonds, and then principal on the storm recovery bonds. An illustrative draft of a form of the indenture between the SPE as Bond Issuer and the Trustee, is included with the testimony of witness Heath as Heath Exhibit 2c.

The capital subaccount represents the equity capital of the SPE and is funded by an amount contributed by DEC and DEP at issuance that is at least equal to 0.50 percent of the initial principal amount of each storm recovery bond transaction. If that subaccount is drawn upon, it is replenished from storm recovery charges through the true-up and any available excess storm recovery charge collections. The Companies' proposed equity investment of 0.50 percent has been derived from guidance from the Internal Revenue Service ("IRS") through its Revenue Procedure 2005-62 (Atkins Exhibit 2). The testimony of witness Heath addresses the Companies' return on this capital contribution at a rate equivalent to the interest rate on the longest-dated tranche of bonds issued in each transaction. The fact that the Companies receive a return on their respective capital contributions contributes to the "equity investment" characterization of these funds. The IRS Revenue Procedure sets forth the way an investor-owned utility may treat, for federal income tax purposes, the issuance of a financing order by a state regulatory agency and the securitization of the rights created by each financing order. Having an equity investment in the SPE of at least 0.50 percent is within the safe harbor provided in the IRS Revenue Procedure and helps to ensure that the Companies will not recognize in their taxable income the cash proceeds received from the sale of storm recovery property or the issuance of the storm recovery bonds. Rather, the storm recovery bonds will be considered borrowings of the Companies for federal income tax purposes. Again, IRS Revenue Procedure 2005-62 is included in my testimony as Atkins Exhibit 2.

The excess funds subaccount is where any monies on deposit in the general account that are not required to meet the scheduled interest and principal obligations of the storm recovery bonds will be deposited. The initial balance is zero, and the target ongoing balance is also zero. To the extent there are funds on deposit in this subaccount, those amounts will be considered in the next available true-up process and the subaccount value will again be generally targeted to be zero. Stated differently, to the extent storm recovery charge collections are higher than expected in any given true-up calculation period, those amounts do not pay down the principal balance of the storm recovery bonds beyond the scheduled principal payment for that period. Rather, the amounts on deposit in the general subaccount above and beyond the scheduled obligations will be moved to the excess funds subaccount. Those amounts will then reduce the amount of storm recovery charge collections needed in the subsequent true-up calculation period. This is how the debt service coverage is targeted to remain at 1.0 times debt service and on-going financing costs, which is quite unique compared to other types of structured debt.

**Q. PLEASE DESCRIBE THE TREATMENT OF ANY FUNDS REMAINING IN THE VARIOUS SUBACCOUNTS AT THE FINAL MATURITY OF EACH TRANSACTION.**

A. Funds remaining in the general subaccount and the excess funds subaccount will be returned to the SPE upon final payment in full of the storm recovery bonds and all other financing costs, and equivalent amounts will be credited to customers' electricity bills as part of the next DEC and DEP rate proceedings. Monies remaining in the DEC and DEP-funded capital subaccounts along with the authorized return, will be returned to the Companies through the SPEs without any equivalent credit to customers' electric bills, since the capital subaccount was funded at issuance with the Companies' own funds.

## III. DESCRIPTION OF PROPOSED TRANSACTIONS

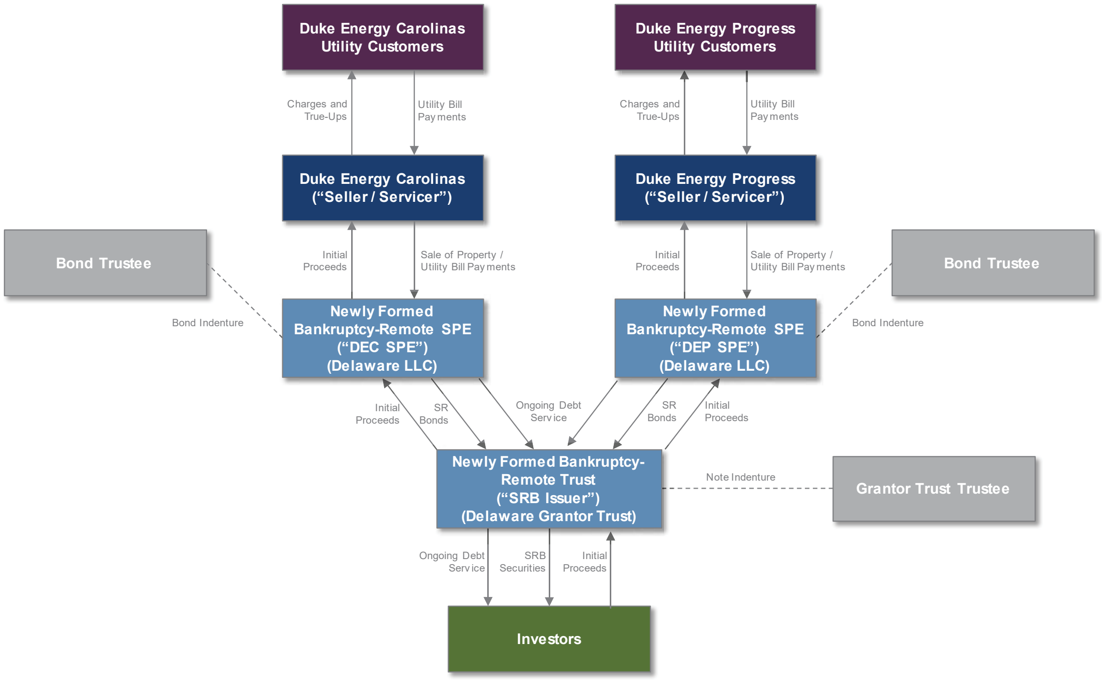
### *A. Transaction Structures*

**Q. PLEASE DESCRIBE THE PRELIMINARY STRUCTURE OF THE COMPANIES' PROPOSED STORM RECOVERY BONDS.**

A. The preliminary structure for the DEC and DEP transactions involves separate SPEs, wholly-owned by their respective Company, that each issue storm recovery bonds. The DEC and DEP bonds are to be issued to a third SPE, a grantor trust that is wholly-owned by Duke Energy ("SRB Issuer"). SRB Issuer issues to the market secured pass-through securities (the "SRB Securities") that are backed by the separate storm recovery bonds issued by DEC and DEP. The structure of the DEC and DEP storm recovery bonds, and the SRB Securities are to be designed to be identical, with respect to tranching, payment dates, scheduled and legal maturities. The true-up adjustment effective dates for the DEC and DEP bonds are also to be the same dates. The debt service payments from the DEC and DEP bonds are to be passed through to service the debt service on the SRB Securities.

This proposed structure, utilizing an SRB Issuer is intended to have several benefits for DEC and DEP customers. First, the storm recovery bond tranches will have the same interest rates, since those interest rates will be set by the interest rates on the SRB Securities. There will be a single marketing process for the SRB Securities, and there will be one pricing. Thus, the risk of the DEC and DEP Bonds being priced on different days with different interest rates will be avoided. Moreover, the storm recovery charges paid by customers of DEC and DEP will be based upon the same interest cost of debt, not different costs of debt. Further, both DEC and DEP customers will benefit from interest rates that are set by a single, larger and more liquid issuance. Larger issues typically attract more interest from investors.

An illustrative diagram of the recommended single issuance structure provided within the Joint Petition is also included below.




**Q. ARE THERE ANY OTHER REASONS FOR RECOMMENDING A SINGLE ISSUANCE OF SRB SECURITIES?**

Yes. If the DEC and DEP SPEs each issued bonds to the market in separate transactions, the DEC storm recovery bonds, due to minimum size requirements, would not qualify for inclusion in the Bloomberg Barclays Aggregate Bond Index ("Index"). Fixed income securities that are included in the Index are generally received favorably by investors, since the performance of fixed income portfolio managers is often assessed by taking the Index into account. In addition, securities that are included in the Index are considered to be more liquid and therefore more likely to price at a lower interest rate. A single larger issue of SRB Securities would meet the minimum issuance size requirements for the Index. This recommended structure would avoid any potential cost of funds disadvantage that the smaller DEC issuance may have if the DEC and DEP storm recovery bonds were issued to the market separately.

**Q. PLEASE PROVIDE MORE DETAILS REGARDING THE PROPOSED STRUCTURE OF THE DEC AND DEP STORM RECOVERY BONDS.**

A. The preliminary structure for the estimated $230.8 million DEC storm recovery bond transaction and the estimated $748.0 million DEP storm recovery bond transaction proposed is presented in Atkins Exhibit 4. Atkins Table-1 below shows on a preliminary, indicative basis, five tranches of bonds, which will amortize in a sequential manner, along with the indicative credit spreads to benchmarks and the associated interest coupons, scheduled final payments and rated legal maturities.

I recommend that the initial debt service payment be scheduled for approximately nine months after the closing of the transaction, with debt service payments thereafter occurring on a semiannual basis. While storm recovery charges are to become effective the day following the issuance of the storm recovery bonds, the accrued charges will not be applied to customer bills until the immediately-following billing cycle month. Thus, considering the standard roll-out of customer bills over a 20 business day billing cycle, and given other lags in collections, it will take some time for the full expected cash flow from storm recovery charges to be realized. Therefore, the approximately nine-month initial period allows more time for the full amount of expected storm recovery charge revenues to become available and also provides for a mandatory true-up adjustment prior to the first debt service payment, to mitigate the transaction revenue impact of any unexpected changes in the DEC and DEP customer base or revenues.

Please note that these terms are preliminary and estimated based on current market conditions. The final terms and conditions of the storm recovery bonds will not be known until they have been priced in the marketplace. Investor demand at the time of pricing will determine market-clearing interest rates and the final structure offered to investors. Therefore, this preliminary structure and pricing information is illustrative and subject to change, and the actual structure and pricing will differ, and may differ materially from this preliminary structure.

As noted in the exhibit, the preliminary structure of the SRB Securities and the underlying storm recovery bonds includes five tranches. Further details are included in Atkins Exhibit 4. The structure shown is designed, as of October 9, 2020, to provide an efficient distribution of securities across the maturity spectrum and thus the lowest weighted average cost of funds to the issuer given the targeted approximate 15-year scheduled final payment date. The level of Storm Recovery Charges paid by the Companies' customers is directly affected by interest rates and the principal amortization structure of the storm recovery bonds. Because of the expected size of the transactions, several tranches (*i.e.*, individual bond tranches with different maturities and average lives) can be structured to take advantage of discrete pockets of investor demand across the entire term of the transaction and to maintain large enough tranche sizes to ensure secondary market liquidity for the SRB Securities, which is a consideration for investors during the bond marketing and pricing process. Liquidity in this context refers to the ability of a noteholder to sell the note in the secondary market without having to discount significantly its price.

Average life is a measure of the average amount of time it takes to repay in full the principal balance of a bond tranche. Regularly scheduled principal amortization throughout the life of the transaction, as opposed to a single bullet maturity, results in a shorter average life for the financing and lower interest costs, resulting in lower storm recovery charges for customers. Investors have nearly universally seen and accepted semiannual or quarterly amortization in these transactions. I have advised the Companies that the proposed transaction should have a relatively level annual debt service and associated revenue requirement, such that as the Companies' customer populations and customer consumptions may increase, all other things being equal, the storm recovery charges may be adjusted downward over the life of the transaction. Rating agency "AAA" or equivalent stress tests would tend to penalize transactions that use a different structuring approach, particularly one that significantly back-loads debt service.

As previously noted, rating agency requirements and investor demand at the time of pricing will determine market-clearing interest rates and the final tranching offered to investors. Therefore, the structure and pricing information presented here are preliminary and subject to change, and the actual structure and pricing can be expected to differ, perhaps materially, from the information provided in Atkins Table-1 and Atkins Exhibit 4.

**Q. PLEASE PROVIDE ADDITIONAL DETAILS AROUND THE PRELIMINARY STRUCTURE OF THE STORM RECOVERY BONDS AND SRB SECURITIES.**

A. Further details of the preliminary transaction structure are provided in Atkins Exhibit 4, which outlines some of the structuring assumptions and displays the preliminary annual debt service schedules and annual revenue requirements.

**Q. WHAT IS THE DIFFERENCE BETWEEN THE SCHEDULED FINAL PAYMENT DATE AND LEGAL MATURITY DATE?**

A. I briefly addressed this topic above in the context of the basic discussion of securitization and will address it more fully here. The scheduled final payment date of the tranches of storm recovery bonds and the SRB Securities represents the date at which final payment is expected to be made, but no legal obligation exists to retire the tranche in full by that date. The rated legal maturity date is the date by which the bond principal must be paid, or a default will be declared. The proposed preliminary structure for this transaction utilizes a legal maturity date that is usually 24 months longer than the scheduled final payment date for each bond tranche, known as a "maturity cushion." The actual maturity cushion will be determined by the final "AAA" stress scenarios required by the rating agencies during the rating process for the underlying storm recovery bonds, and SRB Securities and may be shorter or longer than 24 months. Therefore, it is important that the Financing Orders provide flexibility for the transactions to have the specific maturity cushions required to obtain AAA equivalent ratings, which cannot be determined in advance of the rating agency review process.

The difference between the scheduled final payment date and legal maturity date provides additional credit protection by allowing shortfalls in principal payments to be recovered over this additional period due to any unforeseen circumstance. This gap between the two dates is a benefit to the Companies and contributes to the strong credit quality of the transaction, helping lower the cost of funds on the SRB Securities and therefore benefitting customers. Moreover, many investors in utility securitizations are familiar with this concept, which occurs in all utility securitization transactions and most ABS transactions. The ratings on the storm recovery bonds and the SRB Securities are derived in part based on the assumption that the outstanding principal amount of each tranche will be paid in full by its legal maturity date, and investors would price the SRB Securities assuming the SRB Securities and underlying storm recovery bonds make the final scheduled principal payment in full at the scheduled final payment date, which is earlier than the legal maturity date.

**Q. SHOULD THE TRANSACTION BE STRUCTURED AS A PUBLIC, SEC-REGISTERED TRANSACTION?**

A. I recommend that the SRB Securities be marketed via an SEC-registered, public offering. In general, SEC-registered transactions are considered to be more liquid than Rule 144A or other private placement transactions. Publicly offered transactions are not limited to "qualified institutional investors" or "accredited investors" upon initial issuance or resale as privately placed transactions are, and this broader potential investor universe will potentially be more attractive to investors and more likely to obtain lower interest rate coupons on any particular pricing day.

**Q. WILL THE STORM RECOVERY BONDS AND SRB SECURITIES PAY FIXED OR FLOATING INTEREST RATES?**

A. I recommend that the SRB Securities, and therefore the underlying storm recovery bonds, be issued as fixed-rate securities. First, most utility securitizations have been issued as fixed rate bonds to date. Second, fixed interest rates are necessary to maintain predictable revenue requirements over time. Maintaining predictable revenue requirements facilitates the ongoing management of the customer charge adjustment (or "true-up") process. If floating rate bonds were issued, interest rate swaps would be required to create a fixed rate payment obligation. The use of interest rate swaps would create added risks for customers. For example, a swap incorporated as a part of the securitization structure would require an additional counterparty, so there is a risk of a ratings downgrade or a default by the counterparty providing the swap.

**Q. ARE THERE OTHER IMPORTANT CONSIDERATIONS REGARDING THE PRELIMINARY STRUCTURE OF THE STORM RECOVERY BONDS AND THE SRB SECURITIES?**

A. Yes. I reiterate that it will be beneficial for the storm recovery bonds to be structured to have substantially level annual debt service. This is important because it will facilitate a modest decline in the aggregate storm recovery charges over the life of the storm recovery bonds, assuming actual load growth.

**Q. PLEASE DESCRIBE THE MECHANICS OF HOW THE SRB SECURITIES ARE PRICED.**

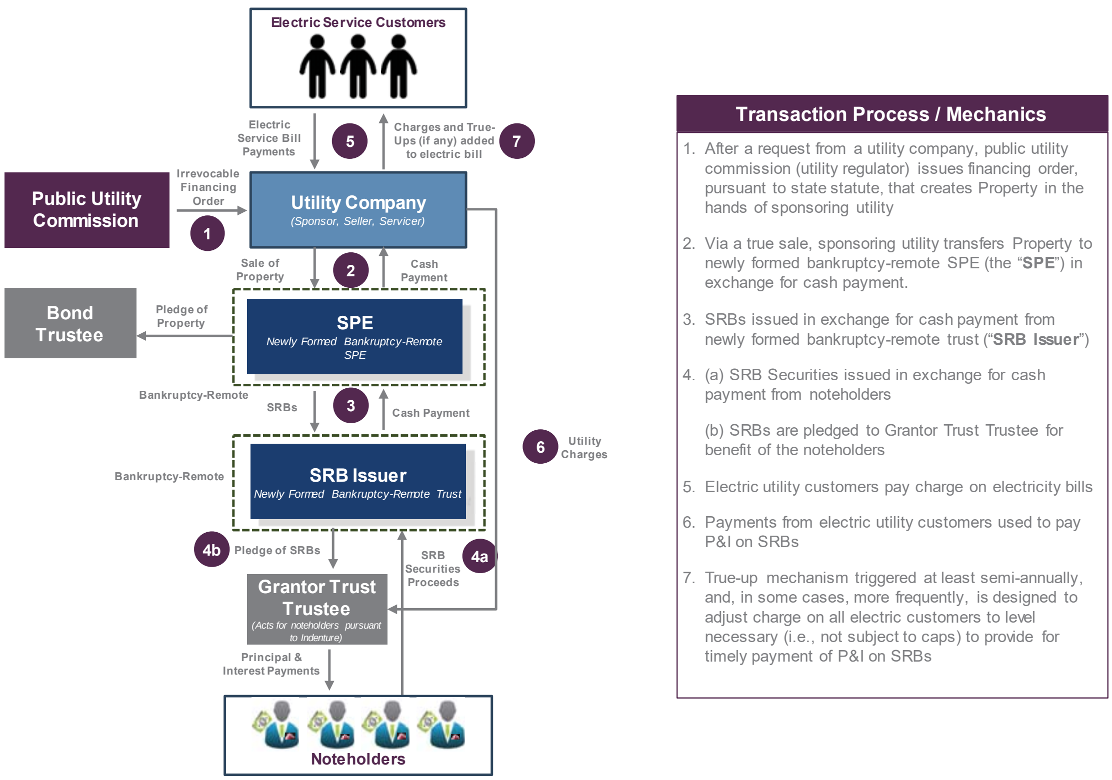
A. The starting point for how each tranche is priced is the corresponding benchmark rate. In the preliminary structure included as Atkins Exhibit 4, U.S. Treasury benchmarks are listed. These benchmark rates are matched with the weighted average life of each tranche. Average life is a measure of the average amount of time it is expected to take to repay the principal balance of a tranche in full. The U.S. Treasury benchmark reflects the "risk-free" yield investors generally associate with securities issued by the U.S. Treasury. Some investors, particularly ABS investors, may evaluate the transaction from the perspective of swap benchmarks. Swap benchmarks reflect the yield demanded by investors for non-U.S. Treasury securities of similar terms, without regard to any further credit spread. Yields demanded by investors in the interest rate swap market for different terms are the basis for the swap benchmarks for similar terms. Investors in the ABS market generally use swap rates as benchmarks, whereas investors in the corporate bond market typically use U.S. Treasury rates as benchmarks. An effective marketing strategy for each Company transaction should enable investors to evaluate the transaction from the perspective of either or both benchmarks.

The next consideration is the credit spread, which is generally the amount of yield above the given benchmark that is required by the marketplace to invest in the given bond tranche. This credit spread, the yield above the benchmark rate, is an indication of the market's view of the incremental credit risk associated with each bond tranche. To state the obvious, issuers would like this credit spread to be as small, or tight, as possible to the underlying benchmark (thereby lowering the coupon), and investors would like it to be higher, or wider, versus the underlying benchmark, all else being equal. While corporate investors assessing the attractiveness of a utility securitization may readily convert swap benchmarks to U.S. Treasury benchmarks, and thereby adjust proposed credit spreads accordingly, for investor convenience, underwriters sometimes give proposed price guidance to investors reflecting both benchmarks. I recommend that the underwriters provide price guidance to potential investors reflecting both benchmarks. The pricing credit spread is ultimately determined by market-clearing rates at the conclusion of the marketing process.

***B. Storm Recovery Charge Collection***

**Q. PLEASE DESCRIBE THE ONGOING BILLING, COLLECTING, AND REMITTING OF THE STORM RECOVERY CHARGES OVER THE LIFE OF THE TRANSACTION.**

A. The Companies, as servicers, will be responsible for billing and collecting storm recovery charges from customers. The procedures for remitting storm recovery charges to the Trustee will be established through a Servicing Agreement, a draft form of which is attached to witness Heath's testimony. Storm recovery charges will be remitted by the Companies to the Trustee each business day (based on estimated amounts collected), with cash held no more than two business days prior to remittance. The Trustee will then hold the amounts remitted to it by each Company until the next payment date. These payment dates will generally occur twice a year, as is customary in utility securitizations. An illustrative diagram for the storm recovery bonds ("SRBs") is included below. This structure would be applicable for both issuances of storm recovery bonds by DEC and DEP into the SPE Issuer Trust, which in turn will issue SRB Securities to investors):




Further, while it is my understanding that North Carolina law does not currently authorize third-party energy providers to provide public utility services, it is important that the Financing Orders ensure that such third-parties – in the event there is any change in utility regulation – bill and collect the storm recovery charges in a manner that will not cause any of the then-current credit ratings of the storm recovery bonds to be suspended, withdrawn, or downgraded.

While the rating agency requirements may change from time to time, it is expected that the rating agencies' requirements, in general, will consist of the following:

- Any third-party energy provider must provide DEC and DEP, acting as servicer, (or any successor servicer) with total monthly kilowatt-hour usage information in a timely manner for the servicer to fulfill its obligations, as such information is the basis of such remittance.
- The utility, or any successor servicer, will be entitled, within seven days after a default by the third-party energy provider in remitting any storm recovery charges billed, to assume responsibility for billing all charges for services provided by DEC or DEP, as applicable, or any successor servicer, including the storm recovery charges, or to switch responsibility to a third-party, which must meet the criteria herein described.
- If and so long as a third-party energy provider does not maintain at least a triple-B long-term unsecured credit rating from Moody's Investors Service, S&P Global Ratings or Fitch Ratings, such third-party energy provider shall maintain, with the servicer or as directed by the servicer, a cash deposit or comparable security equal to at least one month's maximum estimated collections of storm recovery charges, in a form and manner as agreed upon by the servicer, or any successor servicer, and the third-party energy provider. In the event of a default in the remittance of storm recovery

charges by a third-party energy provider, such amount will be included in the true-up adjustments.

- The third-party energy provider must agree to remit the full amount of storm recovery charges it bills to retail customers, regardless of whether payments are received from such retail customers, within 15 days of its or the utility's, or any successor servicer's, bill for such charges.
- The foregoing requirements may be modified in accordance with the terms of the storm recovery bond financing documents, subject to approval by the Commission, and confirmation (or deemed confirmation) by the applicable rating agencies that such change will not result in a suspension, reduction, or withdrawal of the then current credit ratings for the storm recovery bonds.

***C. Key True-Up Adjustment Considerations***

**Q. PLEASE DISCUSS KEY ASPECTS OF THE TRUE-UP ADJUSTMENT PROCESS.**

A. One of the fundamental utility securitization features that enables "AAA" ratings is the statutorily mandated periodic true-up adjustment process. The true-up process involves the adjustment of the customer charges on a periodic basis, to ensure that the scheduled securitization debt service and on-going financing costs are paid on a timely basis. True-up adjustments are also designed to minimize any over-collections and target the low 1.0 times debt service coverage. True-ups are to be implemented by the servicer, and by the terms of the Securitization Statute, any reviews by the Commission focus only on potential mathematical or clerical errors present in the true-up submission.

We recommend that true-ups take place on a semi-annual basis, that the true-up calculations occurring in each period take into account actual collections received during months since the prior true-up, as well as scheduled debt service and financing costs projected to be due over the two upcoming debt service payments. The true-up calculation methodology will take into account updated energy usage and revenue forecasts, any changes in the Commission-approved customer rate allocations, as well as updated customer payment aging, delinquency and uncollectibles data.

I recommend that the initial bond payment date be set approximately nine months from the closing date, so that there will be a true-up adjustment effective prior to the first bond payment date. I also recommend that the true-up adjustments become effective in the approximate middle of the bond payment periods, such that generally there are two or three months of customer charges, based upon the adjusted rates, collected prior to the upcoming bond payment date. Setting true-up adjustment dates on such a schedule provides time for charges based upon adjusted rates to be collected prior to upcoming bond payments and is designed to minimize and stabilize charges on an ongoing basis throughout the life of the transaction.

In addition to the required true-ups, it is important for the servicer to have the option to conduct an optional true-up at any time to ensure that debt service and on-going financing costs are paid on time. Witness Angers provides more detail concerning the true-up process in her testimony.

**Q. IN YOUR VIEW WILL THE BROAD-BASED NATURE OF THE PROPOSED TRUE-UP ADJUSTMENT MECHANISM AND THE STATE PLEDGE IN THE SECURITIZATION STATUTE SERVE TO MINIMIZE CREDIT RISK ASSOCIATED WITH THE STORM RECOVERY BONDS?**

A. Yes. I agree that these features serve to minimize credit risk associated with the storm recovery bonds (*i.e.* that sufficient funds will be available and paid to discharge the principal and interest when due).

## IV. DISCUSSION OF THE EXECUTION PROCESS

### *A. Rating Agency Process*

**Q. PLEASE DESCRIBE THE RATING AGENCY PROCESS.**

A. An important element of preparing for the marketing and pricing of the SRB Securities is obtaining the highest ratings on the storm recovery bonds and the SRB Securities from the rating agencies. The Companies and the structuring advisors and lead underwriter for the Companies will prepare written presentations and may meet with rating agency personnel to discuss the credit framework and credit strengths of the proposed storm recovery bonds, and the structure of the SRB Securities with each hired rating agency, in compliance with SEC Rule 17g-5. It is important to note that rating agencies are completely independent institutions, and each rating agency has its own method of reviewing a utility securitization and will request certain data and information that will facilitate such a review process. Rating agencies may update or amend their rating criteria at any time. The Companies' structuring advisors and lead underwriter will work with the Companies to draft presentations that contain the required data and information. Additionally, the rating agencies may require a diligence review of the servicer's billing and collecting processes. Whether this review is done on-site or via the telephone depends on several factors and is ultimately up to each rating agency. Each rating agency will follow-up with additional questions.

The ratings process also entails a review of the cash flows of the proposed structure. As part of this phase, each rating agency will ask for various cash flow stress scenarios based on its requirements and the details of the particular transaction to ensure that the storm recovery bonds and the SRB Securities will be repaid under extremely stressful cash flow projections. These rating agency cash flow stress scenarios may include assumptions that zero out revenues each year during the peak consumption months, that assume that all industrial customers leave the service territory, assume that the widest historical variance between actual consumption and forecasted consumption is multiplied five or more times over the life of the transaction, as well as other stress assumptions regarding write-offs and delinquencies.

Important rating elements include:

- Legal and regulatory framework;
- Political and regulatory environment;
- Transaction structure;
- Servicing review and capabilities;
- Service area analysis;

- Cash flow stress analysis; and
- Size of the storm recovery charge during stress scenarios as a percentage of the average residential customer bill.

**Q. IN YOUR PREVIOUS ANSWER, YOU MENTIONED SEC RULE 17G-5. PLEASE EXPLAIN WHAT IT IS AND HOW IT WILL PERTAIN TO THIS EXECUTION PROCESS.**

A. In December 2009, the SEC amended, as part of its mandate under the Dodd-Frank reform legislation, its rules regulating ratings on structured finance securities where the issuer, sponsor, or underwriter pays for the ratings on the securities. In short, the amended regulation, which I refer to here as "Rule 17g-5" is intended to provide access to ratings-related information to non-hired rating agencies so that they, if desired, could issue unsolicited ratings. In practice, however, actual unsolicited ratings are very rare.

The rule has been in effect since June 2010. Although Rule 17g-5 only directly applies to a hired rating agency, the rule requires the agency to obtain commitments from the issuer to facilitate this process, effectively passing on the requirements to issuers. Those requirements generally include the maintenance of a password-protected website containing rating-related information used to providing a rating on the securities. Each hired rating agency is then required to maintain its own password-protected website listing each structured finance security for which it is in the process of determining a rating. If a non-hired rating agency desires to gain access to the ratings-related information, it can request it of the issuer. Please note, an issuer will be aware of such a request because it will be the one to grant access to the non-hired rating agency.

Utility securitizations have been subject to Rule 17g-5 since its implementation, and issuers and their underwriters have managed the process by maintaining most communication via email and/or recorded or transcribed phone communication. Therefore, it is important that issuers and their underwriters have specific procedures in place to document and record all materials provided to the rating agencies during the rating agency process. In summary, Rule 17g-5 changes the technical nature of how communication takes place during the ratings process, but it has not changed the fundamental nature of that process (*i.e.*, utility securitizations and all other transactions subject to the rule are still rated).

***B. Marketing Process***

**Q. PLEASE DESCRIBE THE SRB SECURITIES MARKETING PROCESS.**

A. The marketing process entails several different phases, each uniquely tailored to the asset class, market conditions and the specifics of this contemplated transaction. The underwriters will work with and make recommendations to the Companies throughout the process. Described below are the general steps in a typical marketing process, but the actual process for the SRB Securities could vary based on the market environment at the time of marketing. Each step below should be conducted consistent with the proposed issuance advice letter procedure described in paragraph C below, as well as with SEC rules and regulations regarding publicly registered securities offerings, including an investor suitability analysis:

1. **Pre-marketing**. Once a preliminary prospectus for the transaction is on file with the SEC, the underwriters will work together with the Companies to bring the transaction to the attention of investors, to inform them of its structure and term, and to answer directly any questions they may have. Extensive education will be provided to investors regarding the storm recovery bonds, particularly investors who may be new to the asset class. A wide range of corporate and ABS investors will be contacted, including investment managers, insurance companies, corporate treasury and other investors. This process is generally referred to as pre-marketing. It may include an electronic roadshow, one-on-one conference calls with significant potential investors, and open conference calls, which several investors may join. The purpose of this process is to stimulate broad investor demand for the issue, so that the pricing process will obtain the lowest possible interest rates reasonably consistent with market conditions at the time of pricing resulting in the lowest storm recovery charges consistent with market conditions at the time the SRB Securities are priced, the interest rates for the storm recovery bond tranches are set and the terms set for in the Financing Orders.

   The timing of this process and the specifics of the new issue process are also important factors. Typically, after an extensive pre-marketing process, new transactions in this sector are announced to the market on Monday mornings. As one could expect, the new issue calendar may be busy at that time, so in order to get the attention of investors as they may be considering several competing new issues, the pre-marketing period will be determined by the Companies and the lead underwriter taking the likely new issue calendar into account. Most transactions that announce on Monday morning will target a pricing by Wednesday or Thursday (as issuers do not want to take the risk of an intervening event over a weekend); thus, a pre-marketing start date is designed to gain the attention of investors when they may not be busy reviewing other active new issue pricings.

2. **Announcement**. Following pre-marketing, the transaction is officially announced to the market, which is typically done toward the start of the week (again, as mentioned above, the timing of the announcement is to ensure that a transaction prices during the same week in which it is officially announced; otherwise, issuers may be subject to unforeseen risk over a weekend). During this phase of marketing, the SRB Securities will be offered for sale to investors through the underwriters. The underwriters, in conjunction with the issuer, will begin to discuss informally with investors the coupons at which the SRB Securities will be offered at initial issuance, stated as a credit spread relative to the benchmark rates for each tranche. In response, investors will provide initial indications of interest, generally specifying how much of the tranche for which they intend to submit an order at a given pricing level. The underwriters will be charged with keeping the master record (known as “the book”) in which all indications of interest

received by the underwriters from potential investors are recorded. The next phase of the transaction – price guidance – will be based on the aggregated amount of indications of interest received from investors.

3. **Price guidance**. At this stage, the underwriters will send out a notice to investors with price guidance, again typically stated as a range of credit spreads stated against the given benchmark. Thereafter, investors will be invited to place firm indications through the underwriters for the amount and specific tranches of SRB Securities they are willing to purchase, at certain prices and bond coupon rates. At a certain point in time, when the book has sufficient interest from investors, the underwriters will stop taking orders (generally referred to as going "subject" to pricing and confirmation). The timing of this step will depend on the specifics of each transaction; however, it will obviously occur only when the book has at least an equal amount of orders for the SRB Securities as the anticipated aggregate principal amount of each proposed tranche (generally referred to as "fully subscribed"). There is no specific threshold beyond that, and it will depend on market conditions, the speed at which orders came in from investors and the composition of investor types in the book, to name a few factors. The underwriters will exercise professional judgment in making a recommendation to take the book subject to final order confirmations, based on all relevant factors. Conversely, if the tranche is undersubscribed, the underwriters may need to increase the coupon or restructure the tranching to attract sufficient investor orders to sell the entire tranche.

4. **Determining pricing levels**. Having exercised professional judgment and taken the transaction subject to pricing and final confirmation of orders, the underwriters and the Companies will then work to refine the pricing levels. Based on the strength of the book, the underwriters may adjust the pricing levels lower (or tighter). This process is generally referred to as testing the pricing levels. It is done to ensure maximum distribution of the SRB Securities at the lowest bond yields reasonably consistent with market conditions. If a tranche is oversubscribed, the underwriters may continue to lower the pricing level (thus improving execution for the Issuer and customers), provided that this adjustment does not decrease the aggregate investor interest below the size of the tranche. If this adjustment is not done correctly, the transaction may fail, which could negatively affect a subsequent attempt. If a tranche is undersubscribed, the pricing level may be adjusted higher until the tranche is fully subscribed. The underwriters will use professional judgment with respect to the recommendation to the Companies for the amount of tightening and number of testing attempts.
5. **Launch**. Once the pricing levels have been determined for each tranche in the transaction, and the registration statement for the transaction has been declared effective by the SEC, the transaction will be launched at a specific pricing level. The intention of this stage is to declare to investors at which pricing levels, or credit spreads, the transaction will be issued. This will be the market-clearing pricing level, subject only to movements in the underlying benchmark rates.

6. **Allocations**. At this stage, the market-clearing pricing level has been determined by the marketing process, but the final book – how much each investor will purchase – has yet to be determined. Here, the lead underwriters will work to recommend to the Companies a specific amount of SRB Securities to be sold to each investor. Each allocation depends on several factors; *e.g.*, the size of each investor's indication of preliminary orders, when the investor submitted its indication, its experience in the sector, its flexibility for the pricing process, the investor type, etc. Ultimately, each investor will purchase its final allocations for the transaction.
7. **Pricing**. Once the market-clearing pricing level and the book has been finalized, the transaction can be priced. At this stage, the underwriters will price the transaction by spotting the underlying benchmark rates and adding the credit spread to determine the coupons for each tranche. Soon after the pricing, the investor orders will be confirmed, and the final prospectus will be provided to investors.
8. **Closing**. At the conclusion of the pricing, the Companies, with its underwriters and legal team, will work toward finalizing the transaction documents and close the transaction, typically approximately five business days after pricing.

In summary, it is through this marketing and pricing discovery process that the actual investor market-clearing interest rates for the SRB Securities are determined. The interest rates for each tranche of the underlying storm recovery bonds will be determined by the interest rates for each tranche of the SRB Securities. It should be noted again that this determination will be specific to the SRB Securities, based on the actual investor orders on the actual day of pricing.

### *C. Key Issuance Advice Letter Considerations*

**Q. PLEASE EXPLAIN THE PURPOSE OF THE ISSUANCE ADVICE LETTER.**

A. The Issuance Advice Letter ("IAL") is prepared by each Company and delivered to the Commission or its designated Commissioner or Commission Staff member ("Designated Member") after pricing the storm recovery bonds. Each IAL will contain the final pricing terms, updated estimates of the up-front and on-going financing costs and certifications from each Company to demonstrate that the issuance of storm recovery bonds satisfies the Statutory Cost Objectives.

**Q. PLEASE DISCUSS KEY ASPECTS OF THE ISSUANCE ADVICE LETTER PROCEDURE.**

A. Each Company has provided the Commission forms of the IAL and True-Up Advice Letter ("TUAL," and together with the IAL, the "IAL/TUAL") as Appendices to the draft Financing Orders. The purpose of the combined IAL/TUAL is because the actual structure and pricing of the storm recovery bonds are unknown as of the time of the issuance of the Financing Orders. Following determination of the final terms of the storm recovery bonds and before issuance of the storm recovery bonds, each Company will provide a combined IAL/TUAL to a Commissioner or Commission Staff member (the Designated Member), for each series of storm recovery bonds, for Commission review. The recommended forms of the IAL/TUAL include issuance standards that if satisfied, demonstrate that the issuance of storm recovery bonds is consistent with the applicable Financing Order within the meaning of the Securitization Statute, prior to the Companies' implementation of the initial storm recovery charges pursuant to the Securitization Statute.

The actual details of the transaction, including certifications from the applicable Company, included with the IAL/TUAL shall be provided no later than the first business day after pricing (unless the Commission, acting through its Designated Member agrees to a longer time). The transaction proceeds without any further action of the Commission, unless the Commission issues an order stopping the storm recovery bond issuance before noon on the third business day after pricing, because the Commission determines (i) that the IAL/TUAL and all required certifications have not been delivered or (ii) the transaction does not comply with the Standards set forth in the Financing Orders as defined therein. After pricing, views concerning the market conditions affecting the pricing of the SRB Securities should not be a reason to cancel or stop the transaction.

Prior to the filing of the IAL/TUAL and through the period ending with the issuance of the storm recovery bonds, the applicable Company will, to the extent requested by the Commission, provide the Commission or its Designated Member with timely information so that the Commission acting for itself, or through its Designated Member, can participate fully and in advance regarding all material aspects relating to the structuring and pricing of, and financing costs relating to the storm recovery bonds.

## V. DISCUSSION OF THE FINANCING ORDERS

**Q. ARE THE TERMS OF A FINANCING ORDER CRITICAL TO ACHIEVING A SUCCESSFUL STORM RECOVERY TRANSACTION?**

A. Yes. A financing order, when taken together with applicable provisions of the Securitization Statute, establishes in strong and definitive terms the legal right of investors to receive, in the form of storm recovery charges, those amounts necessary to pay the interest and principal on the storm recovery bonds and other ongoing expenses in full and on a timely basis. Proposed drafts of the Financing Orders are provided as Exhibits B and C to the Joint Petition.

As mentioned earlier, each Financing Order specifies the mechanisms and structures for payments of bond interest, principal, and ongoing expenses in a manner that minimizes the amount of additional credit enhancements required by the rating agencies to achieve the highest possible ratings. The highest possible ratings will allow the financing to achieve the desired results. In addition, each Financing Order, when taken together with applicable provisions of the Securitization Statute, will enable the relevant Companies to structure the financing in a manner reasonably consistent with investor preferences and rating agency considerations at the time of pricing, which is also necessary for the financing to achieve the desired results.

**Q. WHAT ARE THE KEY ELEMENTS OF EACH FINANCING ORDER THAT ARE ESSENTIAL TO ACHIEVING THE DESIRED RESULT FOR THE TRANSACTION?**

A. The Securitization Statute sets out several key elements for each Financing Order. Once the storm recovery property is created, one of the most important elements is insulating the transaction from the risk of any potential bankruptcy risk of the Companies, which is accomplished via a legal "true sale" of the storm recovery property to each SPE. The structure utilized with this transaction, along with other securitizations, relies on features that allow the rating agencies and investors to conclude that the issuer of the securitization, each SPE, is highly unlikely to become the subject of a bankruptcy proceeding in the unlikely event of a bankruptcy of one or both of the Companies. Under the Federal bankruptcy code, payments on the debt obligations of an issuer in a bankruptcy proceeding become subject to an automatic stay – *i.e.*, the payments are suspended until the courts decide which creditors of the issuer are to be paid, when they will be paid, and whether they are to be paid in whole or in part. Unless the risk of an automatic stay in the unlikely event of a bankruptcy of the Companies is essentially removed from the rating agencies' credit analysis, the financing cannot achieve the highest possible ratings, since the Companies' secured debt obligations are rated below "AAA."

In addition, the creation of a bankruptcy-remote SPE, which is legally distinct from the utility, is designed to limit the ability of such SPE to be included with the Company in the unlikely event of a Company bankruptcy.

Therefore, even if the Company were to declare bankruptcy, the SPE would not become the subject of the Company's bankruptcy proceeding, and the SPE's debt service payments to investors would not be subject to the Company automatic stay. The transaction, as structured and reflected in the Financing Orders, is intended to achieve this important element. This legal structure is supported by true sale and non-consolidation legal opinions from experienced legal counsel.

**Q. ARE THERE ANY OTHER COMPONENTS OF EACH FINANCING ORDER THAT ARE ESSENTIAL TO ESTABLISHING THE LEGAL FOUNDATION FOR THE TRANSACTION?**

A. There are several provisions in each Financing Order that ensure that each SPE will be deemed to be bankruptcy-remote in addition to the elements mentioned above, including that each SPE will have at least one independent manager whose approval will be required for certain organizational changes or major actions of such SPE, such as a voluntarily filing for bankruptcy by that SPE. Each Financing Order will also enable the transfer of the storm recovery property from the Company to the SPE to be a "true sale." As discussed above, a true sale is a sale that a bankruptcy court should not overturn in the case of any Company bankruptcy. Each Financing Order will allow its SPE to issue the storm recovery bonds, pledging the storm recovery property as security for payment on the storm recovery bonds.

**Q. DOES EACH FINANCING ORDER PROVIDE FOR ANY CREDIT ENHANCEMENT TO THE TRANSACTION?**

A. Yes, in a number of forms. The primary form of credit enhancement is the True-up Mechanism. Each Financing Order, together with Securitization Statute, ensures that the collection of storm recovery charges arising from the storm recovery property is expected to be sufficient to pay all amounts owed on the storm recovery bonds on a timely basis and in full, even in the face of dramatic reductions in electricity usage by the relevant Company's customers or dramatic increases of delinquencies and losses on payments from such Company's customers. The True-up Mechanism represents the most fundamental component of credit enhancement to investors and is a cornerstone of utility securitizations. True-ups are to be incorporated so that storm recovery charges may be adjusted on a periodic basis to correct for any over- or under-collection of nonbypassable storm recovery charges for any reason and to ensure that the expected collection of future storm recovery charges is in accordance with the payment terms of the storm recovery bonds. True-up adjustments will be made on a periodic basis, at least semi-annually, throughout the life of the storm recovery bonds in accordance with the objective of achieving the highest credit ratings per rating agency requirements and investor expectations, except that beginning 12 months prior to the scheduled final payment date for the latest maturing tranche of each series of storm recovery bonds, the true-up adjustments must be conducted at least quarterly. In addition, I recommend that optional adjustments be authorized to be conducted at any time. The frequency of true-up adjustments throughout the life of the storm recovery bonds will be described in the final offering document for the transaction and will be consistent with rating agency considerations for achieving the highest credit ratings. It is also important to note that pursuant to the Financing Orders, the True-up Mechanism provides for cross-collateralization across customer groups. This means that the revenue declines in one customer group will be made up by storm recovery charge adjustments within that customer group, as well as the other customer groups.

It is critical for rating agency purposes that, insofar as Commission action is required, true-up adjustments are automatic and implemented on an immediate basis subject only to mathematical and clerical error review. True-up adjustments will consider on-going financing costs as well as anticipated debt service requirements, updated electricity usage and customer count forecasts, the then-current Commission-approved customer charge allocation methodologies, in addition to forecasted projections of customer uncollectibles and delinquencies. Pursuant to the Securitization Statute, the True-up Mechanism shall remain in effect until the storm recovery bonds and all associated financing costs have been fully paid and any under-collection is recovered from customers and any over-collection is returned to customers.

The capital subaccount at each SPE funded with an amount equal to 0.50 percent of the initial principal amounts of each respective storm recovery bond transaction will also serve as credit enhancement of the transaction. Also, it is important that the Financing Orders provide for flexibility to include other forms of credit enhancement and other mechanisms (*e.g.*, letters of credit, additional amounts of overcollateralization or reserve accounts, or surety bonds) to improve the marketability of the storm recovery bonds. None are anticipated but it is important to have such built-in flexibility.

**Q. PLEASE EXPAND ON YOUR USE OF THE TERM "NONBYPASSABLE" IN YOUR PREVIOUS ANSWER.**

A. The Securitization Statute and Financing Orders provide that storm recovery charges shall be paid by all existing or future retail customers receiving transmission or distribution service, or both, from the public utility or its successors or assignees under Commission-approved rate schedules or under special contracts, even if a customer elects to purchase electricity from an alternative electricity supplier following a fundamental change in regulation of public utilities in North Carolina. This is another important element of each Financing Order, both for the rating agency process and for investor considerations.

**Q. IN THAT CONTEXT, HOW WOULD THE STORM RECOVERY CHARGE BE AFFECTED IN THE CASE WHERE THE COMPANY IS NO LONGER THE UTILITY IN THE SERVICE AREA?**

A. Each Financing Order, upon the issuance of the storm recovery bonds, creates a binding obligation for each respective Company, its successors or assignees to collect the storm recovery charges for a servicing fee and allows that obligation to be performed by a replacement servicer appointed by the Trustee, if the relevant servicer does not so perform. Thus, the binding obligation to collect and account for storm recovery charges will survive any adverse event to the servicer. This obligation is binding upon any other entity that provides service in the service territory or any other entity responsible for billing and collecting the storm recovery charges on each Company's behalf.

**Q. PLEASE DISCUSS THE IRREVOCABLE NATURE OF EACH FINANCING ORDER.**

A. Each Financing Order is irrevocable, and the storm recovery charges are not subject to reduction, alteration or impairment by any further action of the Commission, except for the mathematical and clerical error review as part of the formulaic true-up adjustment process. Thus, so long as the storm recovery bonds are outstanding, rights and benefits arising from the storm recovery property created by each Financing Order may be definitively relied upon by investors and the rating agencies.

Equally important, pursuant to N.C. Gen. Stat § 62-172(k), the State of North Carolina and its agencies, including the Commission, pledge and agree not to (i) alter the provisions of the Securitization Statute, which authorize the Commission to create an irrevocable contract right or chose in action by the issuance of the Financing Orders, to create storm recovery property, and make the storm recovery charges imposed by each Financing Order irrevocable and binding, or nonbypassable; (ii) take or permit any action that impairs or would impair the value of storm recovery property or the security for the storm recovery bonds or revises the storm recovery costs for which recovery is authorized; (iii) in any way impair the rights and remedies of the bondholders, assignees, and other financing parties; or (iv) except for changes made pursuant to the True-up Mechanism, reduce, alter, or impair the storm recovery charges that are to be imposed, billed, charged, collected, and remitted for the benefit of the bondholders, any assignee, and any other financing party until any and all principal, interest, premium, financing costs and other fees, expenses, or charges, incurred, and any contracts to be performed in connection with the related storm recovery bonds have been paid and performed in full (the "State Pledge"). Investors generally perceive that one of the greatest risks to them is that there is a change in law that affects the storm recovery property, thereby adversely affecting their rights under the Securitization Statute or the Financing Orders.

Pursuant to the Securitization Statute, the SRB Issuer and Securities Holders, as financing parties to the storm recovery bonds, will have the full rights and benefits of the State Pledge. The Commission's affirmation in the Financing Orders of the State Pledge will enhance investor understanding that the risk of an adverse change in law or regulation is remote and will permit counsel to deliver important legal opinions that such adverse changes would not be legally valid.

**Q. PLEASE DESCRIBE THE SECTIONS OF THE FINANCING ORDER ENTITLED, "FINDINGS OF FACT," "DISCUSSIONS AND CONCLUSIONS" AND "ORDERING PARAGRAPHS."**

A. The Findings of Fact, Discussions and Conclusions, and the Ordering Paragraphs of the Financing Orders constitute the means by which the

Commission definitively affirms the conformity of the financing with the applicable provisions of the Securitization Statute. With these findings and conclusions, counsel will have the basis that they need for the highly technical and specialized legal opinions they must issue in connection with the securitization financing, and upon which the rating agencies will rely in assigning the highest possible ratings for the storm recovery bonds. I emphasize that the provisions of the Financing Orders have been drafted with a view toward providing the basis that counsel will need for these essential opinions. With the structure authorized thereby, the stability of the cash flows securing the storm recovery bonds will be maximized. The combination of maximized cash flow stability and highest possible ratings will allow the storm recovery bonds to be structured and priced to meet the Statutory Cost Objectives.

**Q. ARE THERE ANY OTHER KEY ELEMENTS OF THE FINANCING ORDER UPON WHICH YOU WISH TO ELABORATE?**

A. Yes. In addition, in the Ordering Paragraphs of the Financing Orders, the Commission recognizes the need for, and affords the Companies the flexibility to establish, the final terms and conditions of the storm recovery bonds. This flexibility will allow the Companies to achieve the structure and pricing that will meet the Statutory Cost Objectives, including the lowest storm recovery charge, consistent with market conditions on the day of pricing, rating agency considerations, and the terms of each Financing Order.

## VI. DISCUSSION OF THE SERVICING AGREEMENT

**Q. PLEASE DESCRIBE THE CONTENTS AND PURPOSE OF THE SERVICING AGREEMENT.**

A. Each Servicing Agreement is an agreement among the respective Company (in its capacity as the servicer of the storm recovery bonds), the Trustee, and the SPE. The agreement sets forth the responsibilities and obligations of the servicer, including, among other things, billing and collecting of storm recovery charges, responding to customer inquiries, terminating electric service, filing for true-up adjustments and remitting collections to the Trustee for distribution to bondholders. The Servicing Agreement prohibits the initial servicer's ability to resign as servicer unless (i) it is unlawful for the initial servicer to continue in such a capacity, or (ii) the Commission consents and the rating agencies confirm the resignation would not impact the ratings on the bonds. Its resignation would not be effective until a replacement servicer has assumed its obligations to continue servicing the storm recovery bonds without interruption. The servicer may also be terminated from its responsibilities in certain cases upon a majority vote of bondholders, such as the failure to remit collections within a specified period. Any merger or consolidation of the servicer with another entity would require the merged entity to assume the servicer's responsibility under the Servicing Agreement. The terms of the Servicing Agreement are critical to the rating agency analysis of the storm recovery bonds and the ability to achieve credit ratings in the highest categories.

As compensation for its role as initial servicer, the servicer is entitled to earn a servicing fee payable out of storm recovery charge collections. It is important to the rating agencies and the bankruptcy-remote analysis of the transaction that each Company receives an arm's-length fee as servicer of the storm recovery property, and for its services as Administrator of the SPE. Utility securitizations to date have also required an increase in the servicing fee in the unlikely event the Company is no longer able to perform the servicing role, and a replacement servicer must be brought on board. Rating agencies expect that the Company will be the servicer but assume that a replacement servicer may require additional compensation to perform these services, without access to the Company's existing infrastructure and customer relationships. Illustrative draft forms of both the Servicing and Administration Agreements are included with the testimony of witness Heath as Heath Exhibits 2b and 2d.

## VII. <u>CONCLUSION</u>

**Q. PLEASE SUMMARIZE YOUR TESTIMONY.**

A. I believe the Financing Orders, as proposed, will enable each Company to structure a transaction that can achieve the highest possible ratings, and consistent with investor preferences, will enable the Companies to price at the lowest market-clearing interest costs reasonably consistent with investor demand and market conditions at the time of pricing.

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

A. Yes, it does. Thank you.

**BEFORE THE NORTH CAROLINA UTILITIES COMMISSION**

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

| | | |
|---|---|---|
| In the Matter of: | ) | |
| | ) | **REBUTTAL TESTIMONY OF** |
| Petition of Duke Energy Carolinas, LLC | ) | **CHARLES N. ATKINS II** |
| And Duke Energy Progress, LLC for Issuance | ) | **FOR DUKE ENERGY** |
| of Storm Cost Recovery Financing Orders | ) | **CAROLINAS, LLC AND DUKE** |
| | ) | **ENERGY PROGRESS, LLC** |

## I. INTRODUCTION

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

A. My name is Charles N. Atkins II. My business address is 170 East End Avenue, New York, New York 10128.

**Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?**

A. I am Chief Executive Officer of Atkins Capital Strategies LLC, based in New York City. Subsequent to my direct testimony in this proceeding, I have submitted written testimony to the New Mexico Public Regulation Commission on behalf of Public Service Company of New Mexico ("PNM") in connection with PNM's application for a securitization financing order to recover costs related to the early abandonment of its investment in the Four Corners coal-powered generation plant. I have also been engaged as an independent consultant by Credit Suisse in connection to certain structured finance matters. I am submitting this rebuttal testimony solely in my individual capacity, on behalf of Duke Energy Carolinas, LLC ("DEC") and Duke Energy Progress, LLC ("DEP") (each a "Company" or collectively, the "Companies").

**Q. DID YOU PREVIOUSLY FILE TESTIMONY IN THIS PROCEEDING?**

A. Yes. I filed direct testimony and exhibits on October 26, 2020.

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

A. The purpose of my rebuttal testimony is to rebut the validity of certain assertions made by Saber Partners, LLC consultants for the Public Staff ("Public Staff Consultants" or "Consultants").

**Q. ARE YOU SPONSORING ANY EXHIBITS WITH YOUR REBUTTAL TESTIMONY?**

A. Yes. I am sponsoring the following exhibit described below and attached to my testimony:

- Atkins Rebuttal Exhibit 1: Updated preliminary transaction structures and cash flows reflecting an approximate 20-year scheduled final maturity based upon indicative interest rates as of October 9, 2020.

This exhibit was prepared under my direction, and to the best of my knowledge all factual matters contained therein are true and accurate.

**Q. PLEASE SUMMARIZE YOUR TESTIMONY IN THIS PROCEEDING.**

A. Despite the numerous sets of testimony filed by the Public Staff Consultants in this proceeding, their assertions and recommendations boil down to a handful of actually meaningful issues that have a direct bearing on DEC and DEP's Joint Petition or the content or structure of the Companies' proposed Financing Orders. For that reason, I do not rebut every ancillary issue raised by the Public Staff Consultants in their testimony. I instead focus on those assertions and recommendations that, depending on North Carolina Utilities Commission ("Commission") decisions, could impact the Companies' proposed transactions. I also address some of the instances where I consider my direct testimony to be misunderstood or mischaracterized. Specifically, in my rebuttal testimony, I address the following:

- The "Bond Team" Concept;
- The SRB Securities Issuer Trust Structure;

- Bloomberg Barclays Index Considerations; and
- Structuring and Estimated Interest Rate "Errors."

## II. <u>DISCUSSION OF A BOND TEAM CONCEPT</u>

**Q. PUBLIC STAFF CONSULTANTS PROPOSE A "BOND TEAM" APPROACH THAT INCLUDES THE PUBLIC STAFF AND ITS CONSULTANTS; A DESIGNATED COMMISSION REPRESENTATIVE AND THEIR COUNSEL AND/OR ADVISOR; AND THE COMPANIES AND THEIR STRUCTURING ADVISOR, EXCLUDING THE SELECTED LEAD UNDERWRITERS. THE PUBLIC STAFF CONSULTANTS GO FURTHER AND PROPOSE THAT THE PUBLIC STAFF HAVE "CO-EQUAL" OR "JOINT" DECISION-MAKING AUTHORITY ALONG WITH THE COMMISSION REPRESENTATIVE AND THE COMPANIES. IS IT COMMON FROM YOUR PERSPECTIVE FOR AN INTERVENOR TO BE GIVEN EQUAL DECISION-MAKING AUTHORITY AS PART OF A BOND TEAM?**

A. No. I am not aware of, and the Public Staff Consultants have not presented any evidence of, any previous utility securitization transaction sponsored by an investor-owned utility where an intervenor was a member of a post-financing order bond team, or any case where an intervenor had "co-equal" or "joint" decision-making authority with designated representatives of the Commission and the sponsoring utility. For this reason, and the reasons articulated in

Companies witness Thomas J. Heath, Jr.'s testimony, I do not recommend such an unprecedented arrangement.

**Q. IF THE COMMISSION DOES NOT ACCEPT THE COMPANIES' PROPOSED ISSUANCE ADVICE LETTER PROCEDURE, IS THERE ANOTHER APPROACH THE COMMISSION COULD ESTABLISH THAT MAY BE MORE APPROPRIATE THAN WHAT THE PUBLIC STAFF CONSULTANTS HAVE RECOMMENDED?**

A. Yes. As explained in Companies witness Heath's rebuttal testimony, the Companies did not want to presume what level of post-financing order involvement the Commission might ultimately wish to undertake in these proceedings, and therefore proposed an issuance advice letter ("IAL") process that includes Company certificates attesting to key structuring, marketing, and pricing steps that ensure a thorough and transparent satisfaction of the Companies' Statutory Cost Objectives.[1] However, to the extent the Commission wishes to undertake a significant level of post-financing order involvement, the Companies do not object to an approach similar to the one followed during the 2016 Duke Energy Florida ("DEF") transaction.

It is my understanding that the execution process for that DEF transaction was governed by certain "open meeting" regulations specific to Florida, which required DEF to permit intervenors, as they may wish, to observe

[1] *See* Duke Energy Carolinas, LLC and Duke Energy Progress, LLC's Joint Petition for Financing Orders, at 2, Docket Nos. E-7, Sub 1243 and E-2, Sub 1262 (Oct. 26, 2020).

and listen into certain DEF transaction meetings and conference calls. While I am not aware of such "open meeting" requirements applicable to working group discussions for these transactions in North Carolina, it is my understanding that the Companies do not object to inviting the Public Staff, and to the extent it wishes, its outside consultant and/or counsel, to participate in Bond Team[2] meetings. Following this approach, the Public Staff will be informed continuously through the post-financing order period as the structuring, marketing, and pricing of the transactions is undertaken in an open, transparent manner. If the Commission decides to adopt this approach, the Companies will receive and evaluate suggestions from the Public Staff representative, just as they will receive and evaluate suggestions from their lead underwriters, which are proposed to also be invited to participate in Bond Team meetings.

The Companies expect that at least two lead underwriters will be selected for these transactions through a request for proposal ("RFP") process. Thus, for example, in the event that Guggenheim Securities, LLC is selected as a lead underwriter through the RFP process, there will be at least one additional lead underwriter actively providing its views to the Bond Team, independently from Guggenheim Securities, LLC. The active participation of, and input from, more than one lead underwriter fully addresses the concern expressed by some of the Public Staff Consultants that the potential continued involvement of the Companies' structuring advisors in a lead underwriter role could in some way

[2] *See* Rebuttal Testimony of Thomas J. Heath, Jr., at 15, Docket Nos. E-7, Sub 1243 and E-2, Sub 1262 (Jan. 11, 2021) (defining "Bond Team").

present a "conflict" that may be in some way detrimental to the transactions. The Companies disagree with that assertion.

However, if the Commission does adopt the "Bond Team" approach, the Companies propose that only a designated representative of the Companies and a designated Commissioner or a member of Commission staff (the "Commission's designated representative"), have joint decision-making authority. This approach is consistent with the 2016 DEF transaction, as well as transaction precedents highlighted by the Public Staff Consultants in their testimony and discovery responses.[3] As mentioned previously, the Public Staff Consultants presented no prior transactions where intervenors were members of a Bond Team, nor any prior transactions where intervenors were co-equal or joint decision-makers with a commission and the sponsoring utility. I am equally not aware of any precedent for such co-equal or joint decision-making role for a Public Staff representative in these transactions.

**Q. PUBLIC STAFF CONSULTANTS MAKE THE ASSERTION THAT BECAUSE UNDERWRITERS' INCENTIVES IN THEIR VIEW DO NOT PERFECTLY ALIGN WITH THOSE OF CUSTOMERS, A BOND TEAM SHOULD NECESSARILY INCLUDE THE PUBLIC STAFF. DO YOU AGREE?**

A. No. The Public Staff Consultants' assertions regarding underwriter incentives treat the situation as if the underwriters were acting alone and were the sole

[3] Direct Testimony of Rebecca Klein, Principal of Klein Energy LLC, at 22-23, Docket No. E-2, Sub 1262 and E-7, Sub 1243 (Dec. 21, 2020).

decision-makers in these transactions. As witness Heath explains in detail in his rebuttal testimony, the Companies are sophisticated issuers of many billions of securities, and the marketing and pricing process for these transactions will be transparent. The Companies' designated representative and a designated Commissioner or member of Commission staff, if it so chooses, as joint decision-makers, will be involved in the close monitoring and review of the investor order book for the bonds and will sign off on any decision to increase or decrease proposed bond pricing credit spreads, as well as the final bond pricing. This process, combined with the fact that the lead underwriters will be chosen through an RFP, will minimize the perceived risks asserted by the Public Staff Consultants.

## III. DISCUSSION OF THE SRB SECURITIES ISSUER TRUST STRUCTURE

**Q. PUBLIC STAFF CONSULTANTS HAVE TESTIFIED THAT IT IS TOO EARLY TO DETERMINE HOW THE STORM RECOVERY BOND ISSUES SHOULD BE STRUCTURED. DO YOU AGREE?**

A. Absolutely. The Companies will consider the potential costs and benefits associated with several different transaction structures and issuance strategies to determine the options that best enable the Companies to achieve their Statutory Cost Objectives.

**Q. WHAT ISSUANCE STRATEGIES ARE THE COMPANIES CURRENTLY CONSIDERING UTILIZING AND WHAT ARE THE ADVANTAGES OR DISADVANTAGES OF THESE VARIOUS STRATEGIES?**

A. While the Companies have presented the SRB Securities structure as one issuance strategy to consider, there are two other issuance strategies that include marketing and pricing the separate DEC and DEP storm recovery bond transactions at the same time, or marketing and pricing them at separate times, spaced apart by several weeks or months. Spacing the marketing and issuance of the two transactions may result in different pricing and market environments and different costs of funds for the two bond issues and would cause additional carrying costs that would increase the size and cost of the second subsequent transaction.

As I discussed in my direct testimony, while the SRB Securities issuance strategy does involve incremental costs, which will be evaluated closely, this strategy does present the advantage of avoiding the possible timing delay of one issue. In addition, this strategy avoids marketing a separate DEC transaction at the same time as the DEP transaction, where the DEC transaction would not be eligible for inclusion in the Bloomberg Barclays Corporate Index, and the DEP transaction would be eligible for inclusion in that Index. While the DEC transaction is too small to meet the minimum $300 million size requirement for the Corporate Index, the DEP transaction would meet the minimum size requirement for Corporate Index inclusion on a standalone basis.

In the case of a simultaneous marketing of the DEC and DEP issues, investors would have a choice to invest in one transaction or the other, or both. In my experience, when presented with two bond issues simultaneously, some investors may look for differences to justify a higher interest rate on one of the issues. Such differences may be perceived due to a lesser degree of liquidity due to smaller size, the lack of Index eligibility, or both. While market supply conditions may result in the two issues pricing at the same market-clearing interest rates, it is not possible to ensure this, given difficult-to-predict market supply dynamics and differences in Corporate Index eligibility and size. The SRB Securities approach creates a larger single issuance size that can provide investors with greater liquidity and, at the same time, ensures the same cost of funds for both the DEC and DEP customers. These may not be viewed as important considerations by the Public Staff Consultants, but I believe that these factors should be evaluated closely as the Companies pursue their Statutory Cost Objectives.

**Q. PUBLIC STAFF CONSULTANTS POINT TO INSTANCES OF TWO ISSUANCES BEING PRICED SIMULTANEOUSLY AT THE SAME RATES, ARE THERE FACTUAL DIFFERENCES BETWEEN THOSE TWO TRANSACTIONS AND DEC AND DEP'S?**

A. Yes. The Public Staff Consultants have presented a few cases of two issuances priced simultaneously that were issued at the same rates, seemingly to argue against utilization of the possible SRB Securities structure despite agreeing that evaluation of, or limitation to, a specific issuance structure at this time is premature.[4] It is important to note that in cases of securitizations sponsored by investor-owned utilities noted by the Public Staff Consultants, none presented the situation where one smaller transaction that was not Index-eligible had to compete with a larger Index-eligible transaction that was marketed and priced at the same time. While there are always various factors affecting the pricing of debt securities, no one, including the Public Staff Consultants, can ensure that the added factor of one transaction being Corporate Index eligible, and the other transaction not being Corporate Index eligible, would make no difference. A simultaneous separate issuance strategy would face that uncertainty.

There is a clear example of a frequent utility securitization sponsor, Entergy, which decided to avoid such uncertainty through separating transactions. Included among Public Staff Consultant Paul Sutherland's Exhibit 1 list of utility securitizations are two transactions issued by the Louisiana Public Facilities Authority during 2008.[5] One transaction was related to Entergy Louisiana, which was eligible for the Aggregate Bond Index, and the second transaction was related to Entergy Gulf States Louisiana, which was too small to be eligible for that Index. Rather than market and price these two transactions at the same time, Entergy spaced out the pricing of the transactions by approximately a month, with the larger Index-eligible transaction priced first. Entergy followed a different approach in cases where two transactions

[4] Direct Testimony of Joseph S. Fichera, Chief Executive Officer of Saber Partners, LLC, at 47-48, Docket Nos. E-2, Sub 1262 and E-7, Sub 1243 (Dec. 21, 2020).
[5] Direct Testimony of Paul Sutherland, Senior Advisor, Saber Partners, LLC, at Exhibit 1, at 2, Docket Nos. E-2, Sub 1262 and E-7, Sub 1243 (Dec. 21, 2020).

were both too small to be Index-eligible. The two sets of transactions related to those same affiliated Entergy companies in July 2010 and July 2014 were marketed and priced at the same time. I served as Entergy's advisor for each of these six transactions, as well as all the other Entergy-related transactions

As mentioned earlier, in addition to the difference in potential Corporate Index eligibility, there is also a significant size difference between the DEC and DEP transactions. Thus, there is a second uncertainty where the smaller DEC transaction may be disadvantaged competing with the larger, Corporate Index-eligible DEP transaction. The SRB Securities approach would therefore avoid uncertainty concerning both of these factors.

In any case, the Companies completely agree with the Public Staff Consultants that the SRB Securities structure should be and will be closely evaluated, along with the two alternative separate issuance approaches at the appropriate time. Again, this is why the Companies request in their Joint Petition that the Commission grant DEC and DEP the flexibility to determine which of these structures are best tailored to then-existing rating agency considerations, market conditions, and investor preferences.[6]

[6] Joint Petition, at 22-23.

## IV. DISCUSSION OF INDEX CONSIDERATIONS

**Q. PUBLIC STAFF CONSULTANT FICHERA ASSERTS THAT STRUCTURING THE ISSUANCE OF BONDS TO QUALIFY FOR INCLUSION IN THE BLOOMBERG BARCLAYS AGGREGATE BOND INDEX WOULD REQUIRE STRUCTURING THE BONDS AS "ASSET-BACKED SECURITIES". DO THE COMPANIES INTEND TO STRUCTURE THE BONDS AS "ASSET-BACKED SECURITIES"?**

A. No. Regardless of whether the Companies structure the transaction as an issuance of SRB Securities or standalone DEC and DEP storm recovery bonds, the Companies intend to structure the transactions so that any bonds that are issued do not meet the definition of "asset-backed securities" pursuant to Regulation AB. While the SEC is an independent U.S. government agency, the Companies expect that the SEC will accept this characterization, as they did in connection with the 2016 DEF transaction. Treatment of the transaction as securities other than "asset-backed securities" is key to the Companies marketing these transactions as structured corporate securities. Thus, the Companies do not plan to market the transaction as an issuance of "asset-backed securities."

**Q. DO THE COMPANIES INTEND TO STRUCTURE THE BONDS SO THEY ARE ELIGIBLE FOR INCLUSION IN THE BLOOMBERG BARCLAYS AGGREGATE BOND INDEX?**

A. Yes. There are several components of the Bloomberg Barclays Aggregate Bond Index[7] and the Companies have stated their intention to seek inclusion of securities meeting minimum size requirements in the Corporate Index component. The Companies believe that communicating to investors that a transaction is structured to be eligible for inclusion in the Corporate Index component can be potentially beneficial for the marketing of the transaction.

The SRB Securities approach would meet the minimum size requirements for the Corporate Index. On a standalone basis, the DEP storm recovery bonds would also meet the minimum size requirement for the Corporate Index; however, as discussed previously, the DEC storm recovery bonds would fail to meet the minimum size requirement for the Corporate Index. As also stated, the Companies will closely evaluate the several issuance alternatives at the appropriate time and choose the issuance structure that best achieves the Statutory Cost Objectives.

[7]Any reference to the Aggregate Bond Index in my direct testimony was intended to include the Corporate component.

## V. <u>DISCUSSION OF INTEREST RATE "ERRORS"</u>

**Q. PUBLIC STAFF CONSULTANT SUTHERLAND ASSERTS THAT YOU MADE AN ERROR IN THE WEIGHTED AVERAGE INTEREST COUPON IN YOUR DIRECT TESTIMONY AND IN YOUR RESPONSES TO PUBLIC STAFF DATA REQUEST NOS. 5-1 AND 9-2. WAS THERE AN ERROR IN YOUR TESTIMONY OR DISCOVERY RESPONSES?**

A. No. The indicative weighted average interest coupon displayed as part of Atkins Exhibit 4 to my direct testimony and data request responses was not an error. The number presented the "at issuance" average coupon, weighted by the tranche principal amounts. This number is useful for comparisons with other new issues and was not intended to represent an average cost of funds over the life of the transaction.

**Q. PUBLIC STAFF CONSULTANT SUTHERLAND ASSERTED THAT THE COUPONS USED IN THE A-4 TRANCHE AND THE A-5 TRANCHE OF THE PRELIMINARY 20-YEAR SCHEDULED FINAL MATURITY STRUCTURE WERE OVERSTATED. DO YOU AGREE?**

A. I disagree with Public Staff Consultant Sutherland's assertion that the A-4 tranche and the A-5 tranche indicative coupons in my testimony and responses are overstated. Witness Sutherland explains his conclusion based upon a regression analysis of the indicative tranche coupons.[8] However, there are many factors that impact actual bond pricings, including: duration risk

[8] Sutherland, at 27- 28 and Exhibit 8.

premium, issuance size, tranche size, rating, underlying asset class, number of investors participating in the asset class/transaction, number of dealers making markets in the bonds, perceived liquidity of the bonds, available leverage for investors, and perceived relative value versus other similar securities. Relying upon a simple regression analysis ignores many of these factors and is not how bond coupons are actually estimated or priced in the market.

## VI. <u>DISCUSSION OF CLASS A-1 TRANCHE WEIGHTED AVERAGE LIFE</u>

**Q. PUBLIC STAFF CONSULTANT STEVEN HELLER CONTENDS THAT THERE WOULD NOT BE SUFFICIENT CASH RECEIPTS FOR 6-9 MONTHS AFTER THE ISSUANCE OF THE BONDS TO COVER PRINCIPAL IN AN AMOUNT NECESSARY TO ACHIEVE A SIGNIFICANT CLASS SIZE FOR THE CLASS A-1 TRANCHE WITH A WEIGHTED AVERAGE LIFE ("WAL") OF LESS THAN 2 YEARS. DO YOU AGREE?**

A. I agree with Public Staff Consultant Heller's discussion concerning lags in the receipt of customer payments at the outset of the transactions.[9] Indeed, I have a similar discussion in my direct testimony and I recommend that the Companies structure the transactions with a first debt service payment approximately 9 months from the closing date.[10] The preliminary transaction structure presented in my direct testimony includes such a delay in the first debt

[9] Direct Testimony of Steven Heller, President and Analytical Aid, Saber Partners, LLC, at 7-8, Docket Nos. E-2, Sub 1262 and E-7, Sub 1243 (Dec. 21, 2020).
[10] Direct Testimony of Charles N. Atkins II, at 27, Docket Nos. E-2, Sub 1262 and E-7, Sub 1243 (Oct. 26, 2020).

service payment. In my opinion, the Class A-1 tranche with a 1.4-year WAL is of a sufficient size. The principal payment window begins soon enough for the reference benchmark to be the 1-year Treasury (either on a standalone DEC and DEP basis or combined under the SRB Securities approach). As discussed in my direct testimony, this preliminary structure provides the Issuers with relatively level annual debt service.

## VII. CONCLUSION

**Q. PLEASE SUMMARIZE YOUR REBUTTAL TESTIMONY.**

A. I believe the Financing Orders, as proposed, will enable each Company to structure a transaction consistent with the terms of the respective Financing Order that can achieve the highest possible ratings, and consistent with investor preferences, will enable the Companies to price the offered securities at the lowest market-clearing interest costs consistent with investor demand and market conditions at the time of pricing.

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

A. Yes it does. Thank you.

BY MR. JEFFRIES:

Q. Mr. Atkins, have you prepared a summary of your prefiled direct and rebuttal testimonies?

A. I have, yes.

Q. And could you please provide that for the Commission?

A. Of course. Good afternoon, Commissioners. My name is Charles Atkins and I am CEO of Atkins Capital Strategies, LLC. I am serving as a co-financial advisor to Duke Energy Carolinas and Duke Energy Progress, which I'll refer to collectively as the companies and separately as DEC and DEP. I am pleased to appear before you in connection with the Companies' joint petition for storm cost recovery financing orders.

By way of background, while these storm recovery securitization transactions will be the first such transactions done in the State of North Carolina, these transactions are not new to the marketplace. There have been 66 of these transactions sponsored by or related to investor-owned utilities since 1997, and which total over 50 billion in bonds issued. Not only are Duke Energy and its family of companies experienced and also sophisticated issuers of debt, issuing many billions over the years, these transactions will not be the first securitization for Duke Energy. The 2016 1.29 billion transactions sponsored by Duke Energy Florida is the largest recent utilities securitization, the longest large transaction with a 20-year scheduled final maturity, and the first utility securitization to be included in the Bloomberg Barclays Corporate Index.

The securitization process can result in AAA-rated debt that is insulated from the bankruptcy risk of the sponsoring companies, so that the companies' customers may also benefit from a cost of capital that is based on 99.5 percent AAA-rated debt instead of the much higher regulatory weighted cost of equity to that capital that is used in the traditional cost recovery. This lower cost of capital can result in important savings for customers, estimated at approximately 30 percent, as described by company's witness Heath.

There are three main strategies that the companies may use in issuing these bonds to investors. One factor to consider in assessing each of these alternatives is the potential for inclusion in the Bloomberg Barclays Corporate Index. A lot of investors perceive bond issues that are included in the index to be more tradeable, or more liquid, and therefore more attractive than bonds that are not index-eligible. However, there is a minimum 300 million dollar issue size requirement for potential inclusion in the corporate index. Therefore, a stand-alone DEP transaction would satisfy the size requirement, but a stand-alone DEC transaction under these circumstances would not.

One potential issuance strategy is to market and price the DEP and DEC storm recovery bonds separately, spaced out by several weeks or months. This particular separate issuance strategy would mean that the two transactions would face different interest rates and market distance and may have different interest rates that would drive the amount of customer charges. These two customer bases would actually pay. In addition, carrying costs on the second transaction would increase due to a delay of issuance. A second additional strategy would involve marketing and pricing the DEC and DEP transactions simultaneously. Unlike the separate issuance approach, these two transactions would face the same market conditions. However, given that index-eligible bonds are generally believed to be more attractive than bonds that are not index eligible, there is no way to ensure in advance that the smaller DEC transaction would not be disadvantaged when compared to the larger index-eligible DEP transaction. The third issuance strategy is the SRB securities structure discussed in my direct testimony, which would be structured to be eligible for the corporate index. This structure involves SPE subsidiaries of DEC and DEP issuing storm recovery bonds to a bankruptcy remote trust wholly owned by Duke Energy. This trust would then issue notes to the marketplace backed by the DEC and DEP bonds. The interest rates on the trust note tranches would set the interest rate for each of the tranche of the DEC and DEP bonds. Thus, each corresponding tranche of the DEC and DEP bonds would have the same interest rate. While there are certain incremental costs associated with the SRB securities structure which would be reviewed closely, this structure would result in securitization charges based upon the same interest rates, thus eliminating the risk that the smaller DEC transaction might be treated less favorable.

The companies are fully committed to satisfying their statutory cost objective obligations, including the lowest storm recovery charges consistent with market conditions at the time the bonds are priced. The companies will evaluate closely all of the potential benefits and considerations involved in each of these strategies. Specifically, the companies seek approval of proposed financing orders containing all of the key elements for AAA ratings, as well as the flexibility to assess under different structures, various structures and issuance approaches based upon rating agency, lead underwriter and investor feedback, as well as other realtime market factors. If the Commission chooses, the companies have indicated support for a bond team approach, which is also similar to the Duke Energy Florida transaction, where there would be a working group that would participate in the DEF development of the transaction structures and would also review marketing plans and the transaction pricing. The bond team would consist of the companies, their advisor and counsel, the Commission, and its independent outside consultants and/or counsel. The role of the Commission here is unique, since it is the Commission which makes specific findings that are the key to the creation of the storm recovery property and it is the Commission that issues the financing orders. The bond team would receive ongoing feedback and advice from the lead underwriters, the Public Staff and its consultants, and their respective counsel.

This concludes my testimony and I look forward to discussion.

MR. JEFFRIES: Thank you, Mr. Atkins. Chair Mitchell, Mr. Atkins is available for cross-examination and questions by the Commission.

CHAIR MITCHELL: All right. Mr. Grantmyre.

CROSS EXAMINATION BY MR. GRANTMYRE:

Q. Mr. Atkins, my name is Bill Grantmyre, Public Staff attorney. First, were you listening to the questions on Mr. Heath earlier?

A. I was, yes, sir.

Q. And you may not know the answer to this and if it's beyond your field of expertise, that's okay. I don't know how much you know about utility rate making, but he answered twice, once that the payment of normal utility bonds -- I'm not talking about ratepayer-backed bonds, just the regular first mortgage bonds or whatever are ultimately the responsibility of ratepayers, and then he said all utility debt is paid by customers.

My question is, isn't it true that if a

utility goes out and issues a first mortgage bond outside of a rate case, that the payments on that bond do not go into rates until the next rate case when it's incorporated into the embedded cost of debt? Are you familiar with that? If you're not it's okay to say, because I know you're not a rate case guy.

A. I am not a rate case guy.

Q. Okay. Very good. Okay. Now, going to your testimony on page four, line three. This is your direct -- what we're going to do is go through your direct testimony and then we'll finish up with your rebuttal, if that's okay. In that you say that you testified or you were involved in 25 securitizations that included SEC approval, is that correct?

A. Those were all SEC-registered transactions, as far as I recall, yes.

Q. Now, Mr. Heath was worried about civil actions by the SEC as a result of the transaction. In any of those 25 transactions, was there a civil action filed or a criminal action filed by the SEC?

A. I would say no, but in each of those transactions, every single party has to be extremely careful.

Q. And in some of those transactions there was a bond team. You were involved in the Florida transaction with the bond team where Saber Partners was involved and there was no SEC civil action or criminal action, was there?

A. I was not involved in -- I was not involved in that particular transaction.

Q. Okay. Thank you. Now, on page 11, line two -- I'm getting there. I'm sorry. Page 11 on line two you have the words particularly since this will be the first securitization financing orders in North Carolina. So you would admit then that this Commission is new to securitization financing and any time -- will you agree, any time you're doing something, you meet with them before, it's good to get as much guidance as you can?

A. I would say that the scope of the company's proposal is actually based upon a lot of experience, and so I think that the proposed transaction documents are an excellent foundation for a transaction here.

Q. But you say the company is experiencing normal debt and have done this securitization in Florida, but the company represents the shareholders and not the customers, isn't that correct?

A. I would disagree in that I think that interests are aligned in that because this debt is also treated as on-credit debt, especially at Moody's, that there is a strong incentive for each of these companies to work extremely hard to achieve the lowest costs. Interests are aligned there.

Q. Well, there was testimony earlier and you do agree that S&P does not consider this balance sheet debt, is that correct?

A. It is correct, but there is also Moody's as well.

Q. And also for rate-making purposes, it would not be considered debt on the company's capital ratio of debt to equity, and therefore it would not lower the company's equity percentage or require additional equity to balance it out, isn't that correct?

A. What it does do is that the company gives up equity return on these assets, and so that does have an impact on its overall credit ratios, especially in Moody's.

Q. Now, I point you to -- I'm sorry, go ahead.

A. A negative impact.

Q. Now, I turn you to page 14 of your direct testimony and line four where it says these transactions are well understood by many investors. Do you see that?

A. I do, yes.

Q. Now, I turn you to your Atkins Exhibit-3, which is a part of your direct testimony. This lists the 66, as you list it, utility securitization transactions. Do you see that?

A. I do have it, yes.

Q. Now, would you agree in the far right column it says pricing date. Would you agree that since 2014 there's only been four of these transactions?

A. Agreed, yes.

Q. And that's a period of six-and-a-half years. So right now they're not very frequent as compared to the past, is it?

A. I would say that these are not -- these are not done every year, no.

Q. And compared to the past, if we can go back, say, to the second page in 2001, would you accept that there were eight transactions in that same year? I counted them. You might trust me. I don't count very well, but it is eight.

A. It looks like eight, yeah.

Q. And the next year, 2002, there were four in that year. Would you agree to that?

A. I would guess so, yes. I take your word for it.
Q. So can we basically agree that they're a lot less frequent in the last -- since 2014 than they were in the early 2000s, of 2001, 2002?
A. I would agree, yes.
Q. So if in fact they're less frequent, the investors would be less informed as to the unique characteristics of this type financing, isn't that true?
A. I would say that any particular marketing process is going to be a quite -- a robust process and that there will always be investor education. Even when there is a frequent asset class, there is always going to be --
(Reporter interruption due to sound issues.)
A. I just said that there will always be a lot of investor education as an ongoing part of a marketing process.
Q. And did you use the word robust marketing in education or did I imagine that?
A. I did, yes.
Q. Okay. Now, on page 33, line 17 you're

talking about towards the end of the line, an effective marketing strategy should enable investors to evaluate the transaction. Do you see that?

A. I do, yeah.

Q. Would you agree that the more -- as you said earlier, the more robust and the more skilled the marketing strategy and educational process is, the better response is probable from the investor class? Would you agree to that?

A. I would, yes.

Q. And would you agree that Saber Partners is experienced in making marketing and making presentations to investor groups and also active in dealing with the Securities and Exchange Commission?

A. I do not have any information about their experience with the SEC. I do know that they have been quite active in their role of advising commissions. They are not a broker dealer and so they are not involved in the actual market making or the actual trading of bonds. And so I don't think that they have the same amount of market knowledge that underwriters do who are actively involved in the actual marketing and in the actual trading of the bonds.

Q. When you talked about underwriters, isn't it true that the underwriters have no fiduciary duty whatsoever to Duke in this transaction?

A. That is particular -- that is a technical legal point, but I will say that underwriters tend to be competitive. Underwriters tend to try -- they have a lot of professional pride and they are always seeking to do additional business. And so where you have two or three lead underwriters I think that there will be a lot of -- there will be a lot of valuable feedback. And so I think that there will be a lot of positive competitive tension there. And so I think that underwriters can and will do an excellent job, especially when there is -- when you have an experienced company issuer.

Q. Now, are you aware of the data response made by the company that neither the underwriter nor your firm has any fiduciary duty to the Duke companies, is that correct?

A. I am aware of that, yes.

Q. And, again, neither the underwriters nor you would have any fiduciary duty to the customers, Duke's customers, would you?

A. That is a technical legal point, yes.

Q. Now, with regard to the underwriters, did you hear the testimony -- I thought I heard that the fee going to be paid to the underwriters, I believe, was something like 3.8 or 3.9 million dollars. Is that what you remember hearing?

A. I did hear that. And underwriters, they -- as they do undergo an ongoing marketing process and they do take the absolute -- the full risk that investor orders will absolutely fail. And so they are taking underwriting risks on every transaction.

Q. Wouldn't the higher the interest rate on the bonds -- the higher the interest rate is the less chance the transaction is going to fail, isn't it?

A. I would say that in each case and especially here that there will be a quite -- there will be a transparent of the marketing process where the order book, where the actual investor orders will be right there and the joint decision makers will be able to see which investors have made which orders, and then there will be a particular transparent process of adjusting issuing spreads until there is a fully subscribed deal at the absolute lowest price which is attainable.

Q. But you would agree that the more robust the marketing is and the more skilled it is, the more orders you should get for the bonds, assuming that the investors understand the almost nonexistent risk here? These bonds, the risk is virtually nonexistent. Would you agree to that?

A. There is a particular credit spread associated with these bonds and so I believe that it would be inaccurate to say that there's almost no risk here. I would say that there -- that there is a AAA risk, but there's risk. And the absolute fact that these bonds have what is called a credit spread, which means that these bonds are issued at an interest rate which is higher than -- which is higher than a particular U.S. Treasury rate, that absolutely means that there is a different risk associated with these bonds. And it is also true that unlike other structured debt, these bonds don't have over collateralization, which means that there are not extra assets which are being pledged here. That there is no -- that there is no real excess coverage. And so that means that all of these bondholders really are looking to the ongoing true-up process in order to ensure that these bonds are going to be paid. And so there has to be complete confidence and absolute faith that the investors have that there's going to be a very, very smooth true-up process in order for these bonds to be paid because there isn't any extra cushion here like there is for a credit card deal or a student loan deal.

Q. But the true-up basically almost fully protects the investors in that the Commission will change the charge to the customers to make sure there is enough payments. And would you also say that Duke is an experienced company dealing with true-ups, as is the Utilities Commission?

A. I would say that Duke is experienced and I would say here that these particular true-ups are being implemented by the servicer, which is a Duke entity, and there will be a letter that is given to the Commission which is to be an automatic process. It is a formula-base process where the Commission by the statute, the scope of the review of those true-up letters is only for mathematical or for clerical errors. Otherwise it needs to be automatic. And so it is quite important that the investors and also rating agencies have the understanding and the faith that the true-up process is going to be an automatic formula-based process where there will not be any interveners there, that it is an automatic process.

Q. Well, I turn your attention to page 42 of your testimony and on line 17. And I'll just read it.

It says the underwriters will work with and make recommendations to the companies throughout the process. But as we have said earlier, the underwriters really have no fiduciary duty to the company. And isn't it also true that underwriters are also driven to complete the deal as quickly as possible so they can move on to the next deal, which may be 3.8 million or maybe more or less? Isn't that a fundamental incentive for underwriters?

A. Underwriters have an incentive to do an excellent job and they are going to -- they always want to do their best job and they especially are going to want to do a good job for Duke. I would add also for -- in order to be hired by Duke again. And so I think that incentives are all aligned here. I think that Duke has an incentive to keep all these charges as low as possible because of -- especially Moody's has highlighted that having these particular superpriority obligations reduce the amount of flexibility that these companies have in order do capital investments and in order to invest in clean energy and other things. And so -- and then there could also be additional storms. And so I think that all of the incentives are aligned in order to keep all of these charges as low as possible.

Q. Now, I turn you to page 43 of your testimony.

CHAIR MITCHELL: Mr. Grantmyre, I'm going to interrupt you for just a moment. We're going to take a very short break for our court reporter. Let's go off the record. We'll go back on at 4:05.

(A break was taken, 3:57 p.m. - 4:05 p.m.)

CHAIR MITCHELL: Mr. Grantmyre, you may resume your cross-examination of the witness.

BY MR. GRANTMYRE:

Q. Mr. Atkins, earlier we were talking about the U.S. treasury bond rates. Isn't it true that they are exempt from state taxes and therefore that's one reason their rates are lower?

A. I will say yes, but I think that they are -- they are deemed to be -- they are considered to be -- they are considered to be risk free, even though it is a sovereign credit and it still has risk. But at least in these markets it is considered to be risk free, but it does have risk.

Q. Going back to where we were on page 43, I'll read the two lines. It says extensive education will be provided to investors regarding storm recovery bonds, and in particularly investors who may be new to this asset class. So this follows up for what we talked about earlier, that there are new investors to this asset class. There have not been as many transactions recently. And basically would you agree that there needs to be very strong education, as you say, extensive education? Would you agree to that?

A. I would agree that the underwriters and the company through the investor road show can educate investors about the specific strengths of this transaction. And so there is a particular formal process that has to be taken, especially since these are SEC transactions, and so that has to be done quite, quite carefully. It can be done in a particularly robust way, but it has to be done carefully within the SEC regulations.

Q. But the key word you said, that they can do this education. We have no assurance that they will do extensive, robust education, do we?

A. There is going to -- if you take a look at the proposed issuance advice letter, as a part of that particular issuance advice letter is a company certification, and as a part of that particular company certification there is a specific checklist that includes a host of marketing activities. And so investor education will of course be a part of that overall marketing process. And so in the Duke -- the Florida transaction, over 100 investors were contacted and there were more than 50 investors ultimately in that transaction. So I think that Duke has experience in terms of overseeing a quite robust marketing process.

Q. But it's true that Saber Partners was also involved in that process, also involved talking with investors and participating in the marketing and -- so when you say there was a hundred investors, how many of those can you attribute to the Saber Partners' contribution?

A. I cannot really attest to that. I was not a part of that transaction, but I was informed about the overall number of investors who were contacted.

Q. Now, do you have in front of you a copy of the Duke Energy proposed financing order that they filed with the joint petition?

A. It is in a particular book and it is being found now.

Q. Okay. I'm going to refer you to what they call appendix C, which is the form of the issuance advice letter. It's on page 78 of 94 of the joint petition.

A. I do see it, yes.

Q. You got it?

A. Yes, sir.

Q. And I don't know if you have read this recently, but would you agree that nowhere does it say in here that there was any -- it really describes the marketing that the company did or -- it's not going to report anything about the marketing?

A. Hold on.

CHAIR MITCHELL: Mr. Grantmyre, where are you looking right now?

MR. GRANTMYRE: This is the issue advice letter and it goes down on page one. It starts with name of what it's going to report and then on the top of page two again, and then it lists all the representations. But I just don't see anywhere in the document it talks to describe the marketing efforts.

THE WITNESS: If you look at what is called attachment eight, which is the form of the company certification, which is a part of the issuance advice letter.

BY MR. GRANTMYRE:

Q. Would you be kind enough to tell us what page you're talking about? Attachment eight?

A. It is attachment eight. I don't see a page number here. But it is the form of company certification.

Q. And where on this form does it describe in detail the marketing efforts?

A. There is -- there is a whole list of actions that -- there is a set of particular bullet points where it talks about on the next page -- it says that it developed all bond transaction documents, marketing materials and so forth. And then it also goes on to say allowed sufficient time for investors to review marketing materials. And there's questions. And attended investor meetings. And also goes down to say -- it talks about marketing plan and it involves -- also involves conversations with the underwriting team and it talks about conducted in-person and telephonic road shows over X number of investors in X number of cities. And so it talks about a lot of actions here. And so this is the overall form, but it doesn't provide a checklist of actions which -- actions which are going to be taken in order to achieve the statutory objectives. And so it does include investor education and marketing here. This is part of the company certification.

Q. Okay. I will turn you to page 44 of your testimony on line -- excuse me, I'm flipping pages here. Now, nowhere does it say on that certification they made the master record known as the book, they don't go into a description on that, do they? Isn't that the indication of all about who's contacted, where they keep track of all the contacts with investors, but that is not in the certification, is it?

A. I don't think that that particular aspect is, but there is an overall overview of the overall marketing process and the investor road show, it does specify how many investors will participate in the overall investor road show.

Q. Now, on page 46, line eight, you talk about if the tranche is oversubscribed they may continue to lower the pricing level, is that correct?

A. Yes, sir.

Q. So the more robust and skilled the marketing is, the better chance you have -- would you agree the better chance you have to be oversubscribed, and therefore keep lowering or lower the pricing on the bonds or the interest rate on the bond?

A. I would say that there is a real art to the overall issuance strategy and that you should have an experienced team of underwriters who will actually build upon the overall premarketing process in order to come up with what are the particular levels which will be given through the price process. And so I think that that is a particular process that will be closely coordinated with the underwriters who are market makers and who have a secondary trading desk. And so they are in intimate touch with the current market conditions and in consultation with the experienced issuer and also with the Commission representative to undertake an issuance strategy and to come out with initial price guidance after the overall marketing process. But this is a process that has to be done quite, quite carefully.

CHAIR MITCHELL: Mr. Grantmyre, you're muted.

BY MR. GRANTMYRE:

Q. That might not be a bad idea sometimes. But anyway, we're going to your rebuttal testimony. I'm sorry. Which means we're getting closer to the end here. And on page four, line 18 you talk about in none of your previous securitization transactions with investor-owned utility where an intervener was a member of the bond financing -- or bond team, is that correct?

A. Yes, sir.

Q. Now, earlier, were you here when we had Public Staff Heath Cross-Examination exhibit number one, which is the statute, general statute 62-15 talking about the Public Staff? Do you have access to that?

A. I do.

Q. Do you have it available in front of you?

A. I do.

Q. And would you agree that under D it says it shall be the duty and responsibility of the Public Staff to, and then down on three intervene on behalf of using and consuming public in all Commission proceedings affecting the rates or service of a public utility?

A. I do see that. And I also see also in section B there that the Public Staff shall not be subject to the supervision, direction or control of the Commission.

Q. But in B doesn't it also say in the beginning there is established in the Commission -- I use the word in -- the Commission a Public Staff. Isn't that what it says?

A. It does say that, but it also makes it quite clear and I believe that the Public Staff's Website does also cite that the Public Staff is independent. It even says that it is an independent agency. And so -- for this particular statute.

Q. We're proud to be independent but we're also proud to be established in the Commission. In how many of the other cases where you say you never saw an intervener were they required by statute to intervene?

A. You know what, I believe that the Public Staff has intervened in this case.

Q. I know that. But I'm talking about it says it shall. We have a legislative general assembly order that we must, shall intervene. How many other cases is there that language that you have been involved in that the intervener was required by statute to intervene?

A. I don't -- I am not aware of any other case, but I believe that the -- that the Public Staff has intervened and is also giving a lot of input into this overall process during this particular phase.

MR. GRANTMYRE: Now, Chair Mitchell, I

would request that the Commission take judicial notice of Commission Rule R1-19 called Intervention. I'm not going to make it an exhibit, but I just want to ask him a question about it. And it will be a general question to paraphrase it and it is on the list of our redirect exhibits, but it's kind of a general question first.

CHAIR MITCHELL: Mr. Jeffries?

MR. JEFFRIES: Chair Mitchell, yes. To the extent that we're going to ask Mr. Atkins questions about the Commission rules, I don't have an objection to that. I just would like to have a copy in front of him and I would also like to take a second to get a copy in front of me.

CHAIR MITCHELL: Well, what I heard Mr. Grantmyre to say is that it is included in the document --

MR. GRANTMYRE: It's the Public Staff redirectives and it's the very last one, whatever that number is. I don't have electronic access.

MR. JEFFRIES: We should have it.

CHAIR MITCHELL: It's 72. Redirect 72.

MR. JEFFRIES: I have a copy, Chair Mitchell, and hopefully -- Mr. Atkins, do you have a copy of it yet? Excellent. All right. Thank you.

BY MR. GRANTMYRE:

Q. And would you agree, Mr. Atkins --

CHAIR MITCHELL: Hang on, Mr. Grantmyre. For purposes of the record, the Commission will take judicial notice of Commission Rule R1-19. Go ahead.

MR. GRANTMYRE: Since we have it in front of us, I would request that this be identified as Public Staff Atkins Rebuttal Cross Examination 1.

CHAIR MITCHELL: All right, Mr. Grantmyre. We'll identify the document as Public Staff Atkins Cross Examination Exhibit-1.

(Public Staff Atkins Cross Examination Exhibit 1 was marked into evidence.)

BY MR. GRANTMYRE:

Q. Now, I know you haven't read this in detail, but I'm going to summarize it. It says at the top contents of petition. And then halfway down, in order to become an intervener you must file a petition. That's about eight lines down. Do you see that?

A. I do. Yes, I think I do.

Q. So you would agree that interveners in North Carolina, at least pursuant to this rule, other than the Public Staff and maybe the attorney -- and the Attorney General's Office, must file a petition to become an intervener? A verified petition.

A. You know what, I really haven't read this and so I -- I think it says what it says.

Q. Okay. We can agree it says what it says. But the Commission must approve -- will you agree that if you have to file a petition, the Commission must approve you as an intervener?

A. I think it says what it says.

Q. Okay. It says what it says. We'll move on. On page five, line 14 you have the words, it says however, to the extent the Commission wishes to undertake a significant level of post-financing order involvement, the companies do not object to that, similar to Florida, is that correct?

A. Yes. Yes, that's correct.

Q. But in Florida, the Commission hired Saber as its advisor, isn't that correct?

A. That is my understanding.

Q. And you're aware that the Commission does not have its own outside financial advisor at this time, is that correct?

A. That is my understanding.

Q. And if in fact the Commission is going to issue a financing order by February 8th or within the 30 days thereafter, that is -- would you agree, that's a very limited time for them to go out, search for, hire a financing advisor and -- or financial advisor and get any meaningful input?

A. I believe and I have also participated in a quite vigorous -- a quite vigorous regulatory process that is leading up to the -- that is a part of the consideration of these two financing orders. And I do believe that there has been a great deal of input by the Public Staff and that the Public Staff has been quite ably represented. And so I think that there has been a quite robust ongoing process that we are engaged in right now that gives the Commission a lot of food for thought. And so I think that there -- I think that the Public Staff has been quite active.

Q. But you would agree this Commission has never dealt or, to your knowledge, with a securitization bond issuance similar to this where the Commission has to get down into the weeds as to the marketing strategy, the document strat -- the documents and actual pricing?

Would you agree with that? If you have never done it before, how are you supposed to know about it -- all the items that -- all the knowledge that you're supposed to have?

A. I would say that the Commission still has time to appoint a financial advisor that is -- an experienced financial advisor that could advise it if it chooses to have a bond team. And so it will be a process that will take several months and so it will not take a lot of time in order to choose its own advisor.

Q. Yeah. But isn't a key piece that they have to issue the financing order and doesn't the Commission need a lot of advice from either the Public Staff's financial advisor or its own as to the key pieces they should put in the financing order?

A. You know what, I think that there is an ongoing process that is taking place now where there is quite a large amount of input that is coming from the Public Staff and the Public Staff consultants. And so there's been a lot of opportunity to provide input about in terms of the financing order. And I even think that even after this year there will be additional opportunities for input. I believe that the

Public Staff that Mr. Creech actually mentioned that and so I think that -- I think that the Public Staff clearly has intervened and it clearly is giving input.

Q. Now, are you at all familiar with the Florida Commission and the functions of the staff as far as the Florida staff filing testimony representing customers? Are you familiar with that at all?

A. I have not participated in any transactions in the Great State of Florida, unfortunately.

Q. And will you accept, subject to check, that Florida does not have a Public Staff similar to the North Carolina Public Staff?

MR. JEFFRIES: Objection, Chair Mitchell. Mr. Atkins has already indicated he doesn't have any knowledge of the state -- what happens in the State of Florida.

CHAIR MITCHELL: Mr. Grantmyre?

MR. GRANTMYRE: Well, if he wants to say he doesn't know, that's fine.

CHAIR MITCHELL: All right. I'll overrule the objection. I'll allow the witness to answer.

THE WITNESS: No.

BY MR. GRANTMYRE:

Q. This is the last question, so that's the good news. Oh, one other question. When you said that the Public Staff that was ably represented, I'm assuming you're talking about Saber Partners and not the two Public Staff lawyers, is that correct?

A. I believe that a legal education is fantastic. I also am a lawyer. And so I was speaking about the Public Staff lawyers.

Q. Okay. Last question. I promise. Now, one of the things the bond team would do, isn't it correct, whether Saber is part of the bond team and the Public Staff, they would be able to make the decision if you had a single SPE or you had two separate SPEs issuing the bonds for Duke Energy Carolinas and Duke Energy Progress, isn't that true?

A. I will say no, that under the company's proposal the bond team is not a decision maker. That the only -- only two people, the person who is the representative of the company, and the other person who is the representative of the Commission.

Q. Those two -- I'm sorry, go ahead.

A. Excuse me. Those two people are advised by other members of the bond team, i.e. the advisor to the company and the -- the counsel to the company and the advisor to the Commission at one time and the counsel to the Commission. Underwriters would be invited to participate and advise the bond team and also the Public Staff, and the counsel to the Public Staff, and the able consultant to the Public Staff would also have an opportunity to advise the bond team. And so -- but the decision making would be those two identified people that I identified.

Q. I'm sorry, one follow-up question. You realize the Public Staff's proposal is that there be the bond team with the Public Staff having equal decision making authority with the company and that if -- and also the selected commissioner, if it's a commissioner in the bond team, would also have decision making authority. But if there was ever a dispute between the company and the Public Staff, that the presiding commissioner would have the ultimate decision making authority. Do you understand that?

A. I did hear that, yes.

MR. GRANTMYRE: Thank you. I have no further questions.

CHAIR MITCHELL: Mr. Jeffries, redirect of your witness.

MR. JEFFRIES: Thank you, Chair

Mitchell.

REDIRECT EXAMINATION BY MR. JEFFRIES:

Q. Mr. Atkins, in your cross-examination Mr. Grantmyre asked you some questions about the 25 prior bond transactions, some you have worked on, and specifically whether there were any lawsuits filed after those transactions. Do you recall that testimony?

A. Yes, I do.

Q. I'm sorry, I think you're on mute, Mr. Atkins.

A. I do, yes.

Q. Okay. Did any of those 25 prior bond transactions involve an intervener with coequal decision making authority, to your knowledge?

A. Absolutely not.

Q. And not to beat a dead horse, but I want to make sure the record is clear on this. Mr. Heath talked about it a little bit. You talked about it a little bit earlier. I'm having a little trouble completely understanding the nuance between how securitization is treated on the balance sheets or will be treated on the balance sheets of the utilities and the holding company and sort of the positions of S&Ps

and the positions of Moody's on that. Could you explain that for me?

A. Sure. I will start out by basically saying that from a particular GAAP accounting point of view, all of this debt is consolidated in the financial statements of Duke. From time to time there may be a notation in those financial statements that this is nonrecourse debt. But it is still consolidated for GAAP accounting. S&P takes an approach where if these are all properly structured, that they will adjust the particular credit ratios and they will take these bonds out of the company's credit ratios. And so it is treated as off-credit debt under S&P's rating approach.

As far as Moody's goes, they take a completely different approach. They will treat it as on-credit debt and so in their particular report -- there is a particular report that was done in July of 2018 which is called -- which outlines how they particularly treat it. And they do note that during the years of a securitization transaction that it does have a negative affect on the company's cash flow operation versus working capital and debt, credit ratios. It also goes on to say that the particular presence of securitization debt reduces the amount of headroom that the company has to do other things in its rate basin to increase rates for other purposes. And it does also go on to also say that it can reduce the particular flexibility of a company to include capital investments in its rate base. And so especially in the case of storm recovery with climate change, which has been highlighted by the Public Staff consultants, there is a quite possibility of additional storms and the need for additional storm recovery bonds. And I believe that the companies are well aware of that, and so given the fact that these bonds are on credit at Moody's, and given the fact that the companies treat the -- they do view their particular Moody's ratios as being important and they are not unimportant, and given all of that, incentives -- there are strong incentives for the company to keep the customer charges as low as possible because that would tend to minimize any type of negative impact as far as headroom goes. And it also would tend to give space for additional transactions if there are additional storms. And it's good for customers to keep those charges as low as possible. And so all of the incentives are aligned.

Q. Thank you. I feel I understand that now. I appreciate that response.

Mr. Atkins, you have participated in quite a few issuances of long-term debt in the capital markets, is that correct?

A. Yes, I have.

Q. And did all of those -- did all those transactions involve underwriters?

A. Yes.

Q. I'm sorry, was that a yes?

A. Yes.

Q. Okay. So in your experience, does the fact that an underwriter may have an economic interest in pursuing a particular transaction mean that that underwriter is incapable of working to achieve the issuer's lowest cost objectives?

A. Underwriters always try to get additional business and underwriters are not doing these transactions off of their own. They are part of an ongoing working group and they are always overseen by the company, and there is a transparent order book and so the particular -- the company -- and in the case of a securitization, the decision makers will actually see where orders are and aren't.

Q. Okay. Great. I have one last area I would like to ask you a couple questions about. Do you recall Mr. Grantmyre asking you some questions about, I guess, how is the Commission going to know that -- you know, that the companies are engaging in appropriate marketing activities and sufficient marketing activities with respect to these bonds? So let me test my understanding of how this works. So if -- even if the transaction was just the companies and you and the underwriters -- who would you expect the underwriters to be in this transaction? Not by name, by description.

A. Oh, I would expect these would be -- I would expect that there will be at least two underwriters and there just might be two. And that those would be large firms that have a great deal of experience in also structuring and marketing a structured debt, as well as corporate debt. And that they would have active secondary market trading operations. And so I think that there is a difference between underwriters who have almost 24-hour market contact and consultants like me, or other consultants who are not broker dealers and who don't have a secondary trading operation and are not actively making market in bonds. So I would expect that through an RFP process that quite experienced underwriters, especially lead underwriters, are going to be chosen.

Q. Would you expect that between the companies, your experience and the underwriters and with the supervision of the Commission, if they choose to be involved, that these combination of folks would be able to obtain the lowest charge to customers as Mr. Heath indicated he would accomplish?

A. I would, yes.

Q. Okay. Thank you.

MR. JEFFRIES: That's all the redirect I have of Mr. Atkins.

CHAIR MITCHELL: All right. We'll take questions from Commissioners beginning with Commissioner Brown-Bland.

COMMISSIONER BROWN-BLAND: I don't have any questions at this time. Thank you.

CHAIR MITCHELL: Okay. Commissioner Gray?

COMMISSIONER GRAY: No questions for Mr. Atkins at this time.

CHAIR MITCHELL: Commissioner Clodfelter?

COMMISSIONER CLODFELTER: No. Thank you.

CHAIR MITCHELL: Okay. Commissioner Duffley?

COMMISSIONER DUFFLEY: No questions.

CHAIR MITCHELL: Commissioner Hughes?

COMMISSIONER: No questions.

CHAIR MITCHELL: And Commissioner McKissick?

COMMISSIONER McKISSICK: No questions at this time.

CHAIR MITCHELL: All right. That leaves me. I have just a few questions for you, Mr. Atkins, and I will do my best to get through them before the end of the day so you can call it a day.

EXAMINATION BY CHAIR MITCHELL:

Q. All right. Let's see. I want to clear up one question in my mind in your responses to Mr. Grantmyre. I believe you referenced a Moody's report, is that correct? Or some publication by Moody's related to this type of bond in general?

A. I did, yes. And it is a part of the particular record. I believe it is an exhibit. It is a cross-exam -- hold on. It's right here, but hold on.

Q. Mr. Atkins, I'll ask Mr. Jeffries to confirm whether it's in the record and where --

MR. JEFFRIES: My understanding, Chair Mitchell, is it's one of the exhibits in the Public Staff's designated redirect exhibits.

THE WITNESS: It's right here. It is Cross Exhibit-22.

MR. JEFFRIES: Let's confirm that it's cross, not redirect.

MR. ATKINS: It is both. It's both actually. It is page 1307.

COMMISSIONER BROWN-BLAND: Chair Mitchell, there are a bunch of mics that are open at the same time and I think that's causing a lot of feedback that may bother our court reporter.

CHAIR MITCHELL: Okay. Well, at this point you all may mute. Unfortunately, Mr. Atkins, you may not mute, but I think we have identified where the document is at this point.

EXAMINATION BY CHAIR MITCHELL:

Q. Mr. Atkins, I have some questions for you that relate to the settlement agreement that was filed with us yesterday. And so if you are not the appropriate person to answer those questions, you may so state. But let me know who might be. All right. Let me get to my question. The Public Staff and the companies have come to terms on the audit of the ongoing financing clause. As I read the settlement agreement it's a somewhat limited audit for mathematical, clerical errors, charges incurred as a result of gross negligence, recklessness or willful misconduct. I read this to be sort of a narrow -- not your typical prudence review, but something less than a prudence review. Will you confirm my understanding of the scope of the audit that will be conducted?

A. I did not participate in any of those conversations, but I will say that from a particular bankruptcy remote approach that it is key that the ongoing financing costs be actually paid through the securitization charges because each of these SPEs must exist on a standalone basis. And so for all of the bankruptcy remote legal purposes it is quite important that that is a principle which is upheld. But I would defer to company counsel to speak to the details of the settlement.

Q. Okay. Thank you, Mr. Atkins. I will pose those questions to the next company witness.

One question that you may be able to answer. Can you help us understand sort of just a timing question? When will the decision be made as to how to structure the transaction? Whether it's the -- you use the grantor trust structure or some other type of structure. What point in time is that decision made?

A. I would advise that that would be a decision that is made after the elite underwriters have been chosen and then after there is additional feedback on the specific costs involved. And so I think that there should be additional conversations with each of the rating agencies to basically fine tune all of those costs. And so I think that there would be a quite careful way of both incremental costs and also having a view from those elite underwriters what those particular benefits are of each of those three strategies. And so I don't think that that would take a long time, but it has to be done carefully. And then as company's witness Heath spoke about, I think that there would be an additional look about how you'd allocate those incremental costs, that it could be that the -- that a bit more of those incremental costs would be borne by the DEC customers.

Q. Okay. Thank you for that response. Can you -- another timing question for you. Can you help us understand the point in time at which the storm recovery property is transferred to the single purpose or special purpose entities?

A. This is a particular simultaneous process and so the particular -- the storm recovery property is authorized by the financing order, but it springs into being at the time of the -- upon closing. And so -- it is a simultaneous process. And so that is how it happens. And so it does not get involved with any other property liens. And so that's why it springs into being just as it is being transferred.

Q. Okay.

CHAIR MITCHELL: That is it for me. I'll see if counsel have any questions on my questions for the witness. Mr. Jeffries?

MR. JEFFRIES: None from the company.

MR. GRANTMYRE: Public Staff has none.

CHAIR MITCHELL: Okay. All right. With that, Mr. Atkins, we appreciate your time and you may step down.

Counsel, I'll entertain motions.

MR. JEFFRIES: Thank you, Chair Mitchell. The companies would move Mr. Atkins's direct exhibits one through four and Atkins Rebuttal Exhibit-1 into evidence.

CHAIR MITCHELL: Hearing no objection,

Mr. Jeffries, your motion is allowed.

Mr. Grantmyre?

MR. GRANTMYRE: Public Staff would move Public Staff Atkins Cross Examination Exhibit-1 into evidence.

MR. JEFFRIES: No objection.

CHAIR MITCHELL: Hearing no objection, motion is allowed, Mr. Grantmyre.

(Atkins Exhibits 1 - 4, Atkins Rebuttal Exhibit 1 and Public Staff Atkins Cross Examination Exhibit 1 were admitted into evidence.)

CHAIR MITCHELL:

With that we have come to the end of our day. We will be in recess. We'll go back on the record in the morning at 9:00. The line opens up at 8:30 so you're welcome to sign in well in advance of our 9:00.

MR. ATKINS: Excuse me, Chair?

CHAIR MITCHELL: Yes, Mr. Atkins.

MR. ATKINS: I also have deep roots in the great State of North Carolina and so I would just like to say that it is great being here. I have a cousin who also served in the general assembly and also served on the great border regions at the UNC Chapel Hill. So it's great to be back at my other home.

CHAIR MITCHELL: Well, thank you for sharing. Glad to hear it. And I'll also tell you that UNC Chapel Hill is something close to our hearts.

THE WITNESS: Yes, indeed. Thank you so much.

CHAIR MITCHELL: See everybody tomorrow.

(The hearing was adjourned at 5:00 p.m. and set to reconvene at 9:00 a.m. on Friday, January 28, 2021.)

CERTIFICATE OF REPORTER

STATE OF NORTH CAROLINA )
COUNTY OF ALAMANCE )

I, Susan A. Hurrey, RPR, the officer before whom the foregoing hearing was taken, do hereby certify that the witnesses whose testimony appears in the foregoing hearing were duly affirmed; that the testimony of said witness were taken by me to the best of my ability and thereafter reduced to typewriting under my direction; that I am neither counsel for, related to, nor employed by any of the parties to the action in which this hearing was taken; and further, that I am not a relative or employee of any attorney or counsel employed by the parties thereto, nor financially or otherwise interested in the outcome of the action.

This the 3rd day of February, 2021.

SUSAN A. HURREY, RPR
Notary Public #201826800211