XBRL-CET Construction Energy Transportation

RE	:	State of North Carolina Utilities Commission Docket No. E-100, Sub 101 Before The North Carolina Utilities Commission
In The Matter Of	:	Petition for Approval of Revisions to Generator Interconnection Standards Technical Conference April 23, 2015
Specific Item	:	Removal of the Surety Option for Interconnection Security

Background

Background on Interconnection Security Requirement

The 2007 Energy Independence Act was intended to promote the development of new energy sources by encouraging entrepreneurial activity to develop projects that would contribute to the Smart Grid, transitioning from a controlled marketplace to an open buyers and seller's marketplace where the free market and interoperability was allowed to work for the benefit of all stakeholders and result in more energy generating facilities being constructed.

The transition to an open market for energy production is very challenging, but for the emerging Smart Grid to function as intended innovation and creativity is needed, and new approaches that enable more efficient design, procurement and construction, including financing, will evolve to transform the nation's energy infrastructure into a modern Smart Grid. Where interoperability drives innovation and information management and administration produce an efficient and resilient Smart Grid as a national asset.

The interconnection process for private energy facility developers and resulting security requirements emanate from the 2007 legislation, and are part of the evolving effort to develop policies and procedures to implement its objective of promoting the open marketplace for energy generation.

The XBRL-CET working group is exploring the concept of "Harmonized Financial Data", which coordinates data modeling for financial reporting utilizing XBRL with innovative default risk management tools to improve access to capital for entrepreneurial development of energy producing facilities, while mitigating default risk through better communication of project data during the underwriting and investment decision period all the way through construction.

Surety bonds are an integral component of managing default risk, and can play an important role in building the nation's energy infrastructure with specially tailored products and services.

Surety Background

Surety bonds is often misunderstood as insurance, which is understandable because it is underwritten by insurance companies, or as a "bond" financing instrument. Surety is neither, it is a financial product where the resources and default management expertise of major financial institutions are party to a contract ready, willing and able to step in and assume the obligations of the bonded contract and cure a default on behalf of the failing principal (Energy Facility Developer) for the benefit of the obligee (Utility), per the terms of the underlying agreement.

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While the obligee (Utility) has no obligation to the surety for the expense incurred to cure the default, the principal will have a debt to the surety and the surety will seek recovery from the principal for all loss, cost and expense for curing the default. Making it a credit instrument, not an insurance policy.

The simplistic difference between a letter of credit and a surety bond is the letter of credit pays "on demand" and the surety pays on "default", but the difference is actually more than that. The surety assumes the obligation of the defaulted principal, thereby relieving the obligee of the need to directly manage a default and effecting the cure. All the obligee has to do is communicate the valid default and the surety will step in as obligated under the bonded agreement.

Where surety may have its detractors is that defaults can be problematic, particularly when the default is a matter of dispute. Often the obligee is frustrated with having to prove default in order to secure protection under the bond, but that distinction should not be a barrier to any obligee when the default is valid. If the default is not valid, the principal deserves the rights under the agreement to defend themselves and the NCUC should not look to limit security options as a way to deny developers contractual rights provided in the interconnection agreement.

Unless it is the determination of the commission that it seeks financial security that denies developers rights afforded under the interconnection agreement, the surety bond should be one the acceptable forms of security.

Benefits of Surety

Surety also has a number of unique features that make it a potentially better product than a letter of credit, namely the underwriting is geared to understanding the obligations of the underlying agreement and assessment of the principals qualifications to undertake the obligations from both an experience and financial perspective. Also, the surety will only support contracts it has the ability, expertise and resources to assume if there was a default, making a surety a qualified project partner.

The Letter of Credit is often backed by cash collateral, making the underwriting a mute point. This will prevent some development entities from participating, because the ability to post significant cash will be a barrier to investment, and in spite of the qualifications and resources of the developer or the merits of their project.

This barrier does a disservice to North Carolina and contrary to the objective of promoting more clean energy sources.

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Clarification of Issues Raised

One issue raised in written testimony was that surety, as an insurance product, can be voided for lack of premium payment by the developer, or the surety can relieve itself of any obligation by cancelling the bond leaving the utility with no protection or remedy to cure the default.

The authors are not wrong in their concern, as there are surety products that do provide cancellation and would, under certain circumstances, exonerate the surety before the exposure was concluded.

However, that is not the case with the surety bond form proposed. That proposed bond form is designed to address not only the unique nature and obligation of interconnection agreements, but designed to contribute to interconnection process with expertise in underwriting and should there be a problem, default mitigation capabilities to protect the utility.

Once issued the bond cannot be voided for non-payment of premium. The surety is obligated until exonerated by the underlying agreement terms being satisfied or released by the obligee.

Yes, the surety may cancel the bond. However, should the developer not replace the cancelled bond with another suitable financial security they would be in default of the interconnection agreement, which remains an obligation of the surety seeking to be replaced. If the developer was unable to cure the default by replacing the cancelled bond, then the surety would be obligated to cure the default including posting cash with the utility.

If the situation warranted such extreme action by the surety, then it is in the best interest of the Utility to have the issue dealt with expeditiously by the surety to bring the matter to head, instead of letting a deteriorating situation get worse to the determent of all stakeholders.

If, on the other hand, the switch was beneficial for the developer, then having that ability to replace the surety is good for stakeholders and does not adversely expose the utility.

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Construction
Energy
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Summary

The North Carolina Utilities Commission should not eliminate the surety option, but instead should explore the merits of surety protection for utilities and for improving access to capital for building the Smart Grid.

Electing to deny the surety option in North Carolina will prevent stakeholders from having options that can utilize emerging technologies and resources that allow them to build smarter, and will constrain access to capital for projects that otherwise would have contributed to North Carolina's clean energy production.

Should the commission elect to deny developers the surety option all stakeholders would suffer:

- Reduced options do not add value
- Increased capital cost for the collateral required for letters of credit make investment harder.
- Fewer energy generating facilities would be constructed.

Should the commission maintain the surety option all stakeholders would benefit:

- The surety option can improve access to capital for developers.
- Surety bonds have attributes that can be beneficial to the interconnection process
- Surety underwriting provides another level of expertise to project development.
- Surety claims management can relieve utilities from having to deal with problem projects.
- More energy generating facilities would be constructed.

Recommendation

The North Carolina Utilities Commission should participate in the discussion and explore development of a mutually acceptable interconnection and PPA surety bond that protects the utilities while encouraging entrepreneurial activity to develop projects that would contribute to the Smart Grid.

Respectfully submitted for consideration

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