



Staff Report Item 16

TO: East Bay Community Energy Board of Directors
FROM: Howard Chang, Chief Operating Officer
SUBJECT: Prepay Overview and Approval of Counsel (Action Item)
DATE: September 16, 2020

Recommendation

Adopt a Resolution authorizing the CEO to negotiate and execute a Consulting Services Agreements with the following firms for legal representation on EBCE's energy prepayment transaction:

- A. Orrick, Herrington & Sutcliffe - roles of Bond Counsel and Tax Counsel for an amount not to exceed \$400,000
- B. Chapman & Cutler LLP - roles of Disclosure Counsel and Issuer's Counsel for an amount not to exceed \$235,000

Background and Discussion

Prepay Overview:

An energy prepayment - or 'prepay' - is a long-term financial transaction available to municipal utilities and tax-exempt entities such as CCAs that enables a meaningful power procurement cost savings opportunity. Utilizing the municipal bond market, a tax-exempt Load Serving Entity (LSE, also called "Prepay Buyer") and a taxable financial counterparty (bank, called "Prepay Supplier") enter into a 30-year agreement through which the LSE assigns existing power supply contracts to the Prepay Supplier. The Prepay Supplier pays the contract price to the PPA provider, while the LSE pays the Prepay Supplier at a discounted rate. The discounted rate is agreed upon in the prepay documents and is based in part on the spread between the taxable and tax-exempt bond interest rates. The market availability of this interest rate spread is critical to the savings opportunity available to an LSE through a prepay.

Tax-exempt bonds are issued by a third-party conduit to raise funds for the prepay transaction, which flow to the Prepay Supplier. The LSE does a limited assignment of the PPA to the Prepay Supplier. The LSE is required to continue to perform under the contract, while maintaining rights to the electricity and attributes under the PPA. The Prepay Supplier utilizes the bond funds and provides a discount on the PPA to the LSE based on the spread

between the taxable and tax-exempt rates. The discount is estimated at 8-12% but is subject to change based on market conditions.

The total combined notional value of the assigned contracts flowing through the prepay over the 30 years is typically in the range of \$350-\$850MM; these contracts can be long-term renewables PPAs or commodity supply contracts. While the contracts are assigned to the Prepay Supplier, the LSE continues to ultimately take and pay for all the energy and attributes delivered through the contract; all other terms of the PPA remain unchanged. If the prepay program terminates early for any reason - either the Prepay Supplier or the LSE fail to perform - the LSE forgoes future savings and the assigned PPA is put back completely to the LSE.

Two key features of the municipal bonds utilized in a prepay greatly reduce risk to the LSE. First, the bonds are non-recourse to the LSE, meaning they are neither secured nor guaranteed by the LSE and EBCE will at no point be responsible for repaying the bonds. Secondly, prepays are off balance sheet for the LSE as the bonds are issued by a third-party conduit.

Ultimately, prepays are employed to save ratepayers money while maintaining both (a) the economics for the PPA provider and (b) the terms of the energy supply contract. They have been used for natural gas transactions in the US since the early 1990s, with over 90 transactions completed nationwide (\$50+ Billion) and 11 transactions completed in California (\$5.7 Billion). The same tax law¹ and similar transaction structure that enables the natural gas prepays enables the program for electricity, and specifically renewables contracts, creating an opportunity for CCAs to provide renewable energy at a lower cost than the IOU competition.

Solicitation Process:

EBCE and Silicon Valley Clean Energy jointly issued a solicitation in November 2019 to identify potential Prepay Suppliers, through which Morgan Stanley was shortlisted and selected. The two CCAs also jointly issued a solicitation in June 2020 for the counsel roles, through which Orrick, Herrington & Sutcliffe and Chapman & Cutler LLP were selected. Both firms have significant experience representing parties on prepay transactions since the market inception in the 1990s, and both firms are industry leaders in serving the roles for which they've been selected for the EBCE-SVCE prepay.

Prepay Parties:

The prepay transaction requires the selection and involvement of multiple parties. Names and functions are as follows:

Prepay Buyer: East Bay Community Energy and Silicon Valley Clean Energy, jointly

- **Role:** Provide energy contracts to flow through prepay

Prepay Seller: Morgan Stanley

- **Role:** Structure transaction and pay contract price to PPA provider
- **Note:** *No legal obligation or liabilities are being entered into currently; approval of counsel allows EBCE to negotiate documents with Morgan Stanley for which staff will*

¹ Codified in US Tax Law. Since first prepayments of natural gas were done in the early 1990s, the IRS issued rules allowing tax-exempt prepayments and Congress enacted legislation specifically allowing the transactions (National Energy Policy Act of 2005; Section 1327).

later return to the Board for approval of the official prepay transaction and associated bond issuance.

Municipal Advisor: TBD, active solicitation in process

- Role: Advise Prepay Buyer in negotiations; required by Municipal Securities Rulemaking Board (MSRB)

Bond Counsel: Orrick, Herrington & Sutcliffe

- Role: Represent bondholders

Tax Counsel: Orrick, Herrington & Sutcliffe

- Role: Provide tax opinion on transaction

Issuer's Counsel (*also known as Prepay Counsel or Prepaid Counsel*): Chapman & Cutler LLP

- Role: Represent issuer's interests, supporting drafting and negotiating terms of prepay agreement and associated energy supply agreements

Disclosure Counsel: Chapman & Cutler LLP

- Role: Prepare Official Statement / Prospectus

Bond Issuer: TBD, exploring bond issuance conduit with other CCAs

- Role: Issue municipal bonds for prepay
- *Note: The CCA group is in the early stages of development and is discussing the potential of a Joint Powers Authority. No final decisions have been made in regards to the founding members or governance. At this point, planned founding member CCAs are: Marin Clean Energy, East Bay Community Energy, Silicon Valley Clean Energy, and Central Coast Community Energy (formerly Monterey Bay Community Power).*

Timeline:

With the approval of counsel, staff will begin prepay structuring and document negotiations with Morgan Stanley. Draft documents should be prepared for a deal execution by the end of the 2020 calendar year.

Two factors may delay or extend this timeline, however. First, current market conditions have collapsed the taxable vs. tax-exempt bond interest rate spread necessary to go to market with the prepay and achieve the discounts we are seeking. The marketing and execution of the prepay will be dependent upon the appropriate market conditions. Second, power contract assignment consents will need to be executed by PPA providers. Once the transaction structure is determined, staff will identify contracts to assign and go to the respective counterparties for assignment consent; should the counterparties be slow to consent, this could extend the timeline of deal execution.

Financial Impacts

The financial impacts of this item pertain only to the counsel fees, outlined below. These fees may be structured as contingent fees paid out of the proceeds of the prepay transaction upon the successful execution of the program. Alternatively, EBCE may pursue non-contingent fees based on an hourly fee structure, which is subject to further negotiation. In all cases, the total counsel fees total an amount not to exceed \$635,000. These fees would be shared with SVCE as a joint prepay transaction.

- Bond and Tax Counsel: \$400,000
 - Contingent on a successful prepay execution

- Issuer's Counsel and Disclosure Counsel: \$235,000
 - Contingent on a successful prepay execution. If the deal does not materialize fees will be assessed on an hourly rate of \$750/hr up to a max out of pocket of \$30,000

It is important to also note the financial benefit available through the prepay. It is estimated to achieve an 8-12% discount per year on power quantities delivered under the prepay, compared to the assigned contracts. However, the exact discount will be dependent on the spread between taxable and tax-exempt debt rates. While savings are not guaranteed in the structure, there is no negative financial impact associated if the deal does not produce targeted savings levels.

The details of the prepay agreement and expected savings will be brought to the Board for review and approval after documents are negotiated and prepared over the coming months.

Attachments

- A. Resolution authorizing the CEO to negotiate and execute a Consulting Services Agreements for legal representation on EBCE's energy prepayment transaction; and
- B. Prepay Presentation

RESOLUTION NO. __

A RESOLUTION OF THE BOARD OF DIRECTORS OF THE EAST BAY COMMUNITY ENERGY AUTHORITY TO AUTHORIZE THE EXECUTION OF CONSULTING SERVICE AGREEMENTS WITH ORRICK, HERRINGTON & SUTCLIFFE AND WITH CHAPMAN & CUTLER LLP TO SERVE AS COUNSEL ON THE ENERGY PREPAYMENT TRANSACTION

WHEREAS The East Bay Community Energy Authority (“EBCE”) was formed as a community choice aggregation agency (“CCA”) on December 1, 2016, Under the Joint Exercise of Power Act, California Government Code sections 6500 *et seq.*, among the County of Alameda, and the Cities of Albany, Berkeley, Dublin, Emeryville, Fremont, Hayward, Livermore, Piedmont, Oakland, San Leandro, and Union City to study, promote, develop, conduct, operate, and manage energy-related climate change programs in all of the member jurisdictions. The cities of Newark and Pleasanton, located in Alameda County, along with the City of Tracy, located in San Joaquin County, were added as members of EBCE and parties to the JPA in March of 2020.

WHEREAS The pursuit of an energy prepayment enables a meaningful power procurement cost savings opportunity in which EBCE utilizes its tax-exempt status to access the municipal bond market to prepay existing energy supply contracts at a discounted rate.

WHEREAS Orrick, Herrington & Sutcliffe and Chapman & Cutler LLP were respectively selected for the respective counsel roles through a solicitation issued jointly with Silicon Valley Clean Energy in June 2020.

WHEREAS The combined fees for counsel total an amount not to exceed \$635,000.

NOW, THEREFORE, THE BOARD OF DIRECTORS OF THE EAST BAY COMMUNITY ENERGY AUTHORITY DOES HEREBY RESOLVE AS FOLLOWS:

Section 1. Authorize CEO to negotiate and execute Consulting Services Agreement with the following firms for legal representation on EBCE’s energy prepayment transaction: Orrick, Herrington & Sutcliffe - roles of Bond Counsel and Tax Counsel, and Chapman & Cutler LLP - roles of Disclosure Counsel and Issuer’s Counsel.

ADOPTED AND APPROVED this _____ day of _____, 2020.

Dan Kalb, Chair

ATTEST:

Stephanie Cabrera, Clerk of the Board



Prepay Overview & Counsel Selection

PRESENTED BY: Howard Chang
DATE: September 16, 2020



Prepay Overview



Prepay Overview

Structure:

- Term: Typically 30-year term
- Transacting Parties:
 1. Tax-exempt Load Serving Entity (LSE, also called “Prepay Buyer”)
 2. Taxable financial counterparty (bank, called “Prepay Supplier”)
- Process:
 1. Prepay Supplier assigned into existing energy supply contract(s) held by LSE
 2. Municipal bonds issued by conduit, amounting to combined notional value of assigned contracts
 3. Prepay Supplier pays the contract price to PPA Seller, immediately transferring all electricity and attributes to LSE
 4. LSE pays the Prepay Supplier at discounted rate, achieving procurement cost savings
- Takeaway: Prepay Supplier holds and utilizes capital, creating taxable vs. tax-exempt arbitrage that enables discount

Benefits:

- **Lower energy procurement costs**: Savings over 30-year term estimated to be 8-12% per year on power quantities delivered under prepay, compared to spot market purchases and current contracts; subject to change based on market conditions.

Risks:

- **Regulatory**: Addressing risks related to compliance with SB350 and Emissions Performance Standard (i.e. receipt of PCC1 RECs, no disruption to deliveries); specific risks and remediations will be addressed when final prepay transaction is brought to the Board for approval in coming months.

Prepay Overview, Cont.

Further Details on Energy Prepayment Transactions:

- An energy prepayment is a long-term non-recourse financial transaction between a tax-exempt Load Serving Entity (LSE) and a taxable financial counterparty (bank, called “Prepay Supplier”) utilizing the municipal bond market.
 - LSE committing total of ~\$350MM-\$850MM of energy supply contracts (combined contract notional values)
 - LSE utilizes prepay in order to lower customer energy costs
- Municipal utilities (and tax-exempt entities such as CCAs) in the US can prepay for a supply of electricity or natural gas from a taxable entity and fund that prepayment with tax-exempt municipal bonds. The LSE must sell the commodity to their retail end-users residing within their traditional service area.
 - This structure is well known and regularly used for gas and is now being applied towards renewables PPAs
 - Codified in US Tax Law. Since first prepayments of natural gas were done in the early 1990s, the IRS issued rules allowing tax-exempt prepayments and Congress enacted legislation specifically allowing the transactions (National Energy Policy Act of 2005; Section 1327)

Key Elements of a Prepay Transaction

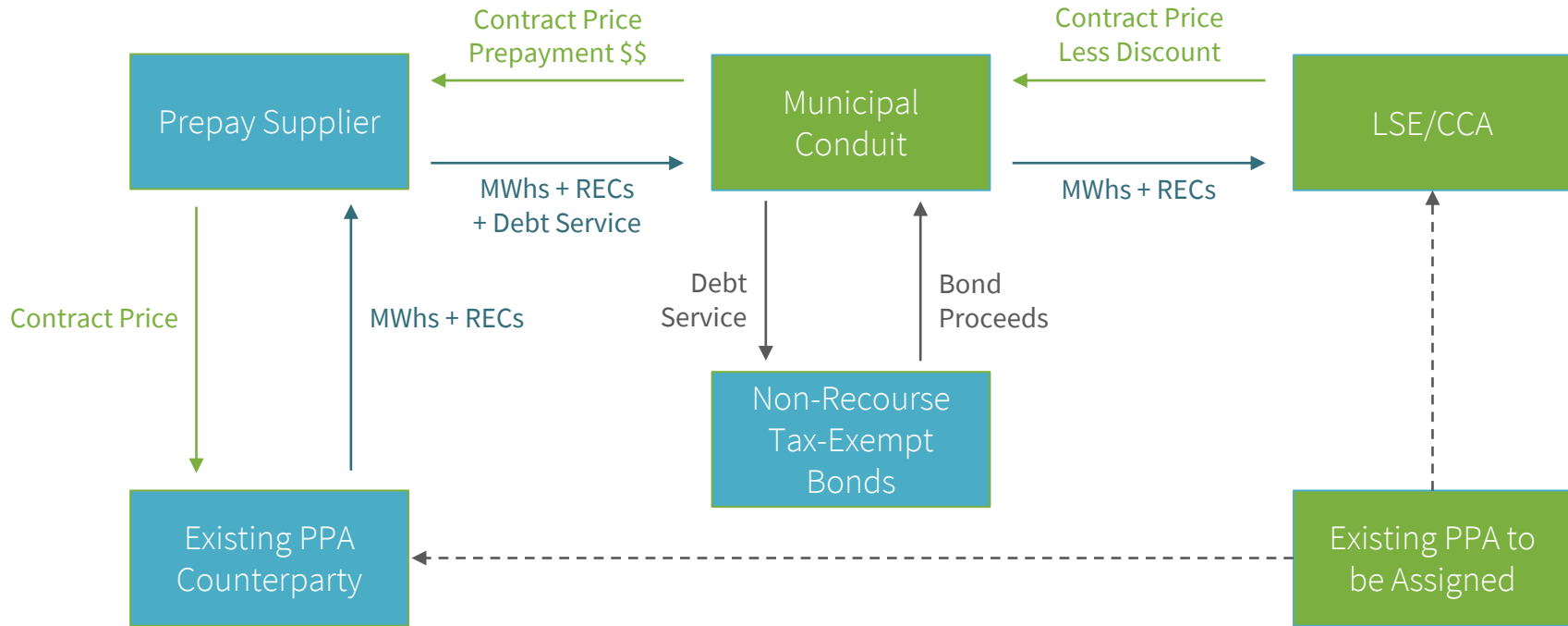
Power Contract Assignment:

- Existing renewable PPAs are assigned to the taxable Prepay Supplier. The LSE continues to **take and pay** for energy and attributes delivered through the contract.
- All other terms of the PPA are unchanged.
- If the prepay program terminates early, Prepay Supplier fails to perform, or LSE fails to perform, the LSE forgoes the future savings and the assigned PPA contract is put back to the original LSE.

Debt:

- Non-Recourse: Prepays utilize non-recourse municipal bonds and are **not** secured or guaranteed by the referenced entity (i.e. the CCA). Rather the debt is recourse to the Prepay Supplier. This significantly protects the CCA and mitigates risk related to the payment of power contracts novated through the prepay.
- Off Balance Sheet for LSE: Bonds are issued by a municipal bond conduit.

Prepay Structure



Market Statistics

- Nationwide: 90+ municipal transactions
 - \$50+ Billion combined notional contract value
- California: 11 municipal transactions
 - \$5.7 Billion combined notional contract value
- Active Suppliers: Goldman Sachs, Morgan Stanley, Royal Bank of Canada, Citi, Bank of America
 - All investment grade rated financial institutions
- Resource Types:
 - Majority of transactions to date have been exclusively for natural gas, remainder including an electricity ‘switch’ at a certain year.
 - The same tax law and similar transaction structure enables the program for electricity from renewables contracts, as well. The market is seeing activity and preparation for these transactions, particularly from CCAs.

Counsel Roles

Counsel Role	Retained By	Function
Bond Counsel	Prepay Buyer (CCA)	Represent bondholders
Tax Counsel	Prepay Buyer (CCA)	Provide tax opinion on transaction
Issuer's Counsel <i>(also known as Prepay Counsel or Prepaid Counsel)</i>	Prepay Buyer (CCA)	Represent issuer's interests, supporting drafting and negotiating terms of prepay agreement and associated energy supply agreements
Disclosure Counsel	Prepay Buyer (CCA)	Prepare Official Statement/Prospectus
Underwriter's Counsel	Prepay Seller (Bank)	Represent the financial counterparty

EBCE Prepay Status



EBCE Prepay Parties

Counsel: Orrick, Herrington & Sutcliffe (Bond & Tax) | Chapman & Cutler LLP (Disclosure & Issuer's)

- Both firms selected through solicitation issued June 2020

Prepay Seller: Morgan Stanley

- Selected through solicitation issued November 2019
- *Note: No legal obligation or liabilities are being entered into currently; approval of counsel allows EBCE to negotiate documents with Morgan Stanley for which staff will later return to the Board for approval of the official prepay transaction and associated bond issuance.*

Joint Prepay Buyer: Silicon Valley Clean Energy

- EBCE and SVCE issued the RFP together, are preparing a joint transaction in which both CCAs assign contracts, share costs and benefits; SVCE is seeking their Board's approval for associated items later this year.

Bond Issuer: TBD

- Exploring conduit with purpose to issue municipal bonds from CCA prepays

Municipal Advisor: TBD

- Active solicitation in process for Municipal Advisor

Bond Issuance Conduit

- The development of a bond issuance conduit is being explored through multiple CCAs for the purpose of issuing municipal bonds for CCA energy prepay transactions. The group is discussing the potential of a Joint Powers Authority.
- The group is in the early stages of development. No final decisions have been made in regards to the founding members or governance. At this point, planned founding member CCAs are:
 - Marin Clean Energy
 - East Bay Community Energy
 - Silicon Valley Clean Energy
 - Central Coast Community Energy (formerly Monterey Bay Community Power)
- There are ‘issuers for hire’ in the California municipal bond market should the conduit not be in place in time for an optimal market execution of the EBCE-SVCE transaction.

Timeline

September 2020:

- Get enabled with counsel
- Issue Advisor RFP
- Begin structuring and document negotiations with Morgan Stanley

Oct. – Dec. 2020:

- Continued document negotiations, preparation
- Identification and assignment of power supply contracts
- Documents ready to execute by end of year
- Document preparation may extend into early 2021 based on market conditions

Factors That May Impact Timing:

- Markets: Taxable vs. tax-exempt spreads need to exist in a meaningful way to achieve discounts we are seeking, and current rate environment is not hospitable for successful prepay. Important to get docs in place to be able to transact quickly when markets open back up, though market conditions could delay timeline of deal execution.
- Assignment Consents: Still need to identify commodity transactions for assignment, and timeliness of consents could extend the timeline of deal execution.

Counsel Approval



Financial Impact

The financial impacts of this item pertain only to the counsel fees, outlined below. Counsel fees total an amount not to exceed \$635,000.

Fees may be structured as contingent fees paid out of the proceeds of the prepay transaction upon the successful execution of the program. Alternatively, EBCE may pursue non-contingent fees based on an hourly fee structure, which is subject to further negotiation. Fees would be shared with SVCE as a joint prepay transaction.

Counsel Role	Party	Fee Amount
Bond Counsel	Orrick	Up to \$400,000
Tax Counsel		
Issuer's Counsel	Chapman & Cutler	Up to \$235,000
Disclosure Counsel		

Action Item: Approval of Counsel

Recommendation:

Authorize CEO to negotiate and execute Consulting Services Agreement with the following firms for legal representation on EBCE's energy prepayment transaction:

- Orrick, Herrington & Sutcliffe – roles of Bond Counsel and Tax Counsel
- Chapman & Cutler LLP – roles of Disclosure Counsel and Issuer's Counsel