

Before the House Financial Institutions and Rural Development Committee
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Informational Briefing Testimony on Securitization-Written Only

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On Behalf of The Staff of the Kansas Corporation Commission

Chair Kelly, Vice Chair Hoheisel, Ranking Minority Member Xu, and members of the Committee, thank you for the opportunity to provide testimony to your Committee today on behalf of the staff of the Kansas Corporation Commission (KCC or Commission).

Background

Securitization, in the context of utility regulation refers to the ability to access special low cost financing, backed (secured) by ratepayers, in order to finance or refinance extraordinary utility investments.

- These “extraordinary” utility investments can be any investment which would otherwise be appropriate to recover from ratepayers through the traditional ratemaking process such as: the undepreciated value of generating plants that have been retired for environmental or economic reasons, storm costs, large cost deferrals, etc.
 - Other examples are: wildfire costs (California), hurricane restoration (North Carolina), and stranded costs for prematurely retired nuclear units (Florida).
- Securitized bonds are designed to receive AAA credit ratings from the major credit agencies, resulting in lower cost financing than traditional utility financing options. Because these cost savings are passed on to customers, securitization can result in substantial benefits to ratepayers. Additionally, there may be related benefits if existing electric generation resources can be replaced with newer more economic sources of power.
 - AAA rated securities would receive very low interest rates in today’s environment (as low as 2-3%) versus the utility’s overall WACC of 9-10%.
- One word of caution with securitization--these bonds receive the high ratings and low cost that they do because once legislation is passed and the Commission issues a financing Order, the utility (or designated special purpose entity) has an irrevocable right to charge current and future ratepayers in the service territory a non-bypassable charge in order to service the securitized bonds. This right cannot be impaired by the State or the Commission in any fashion, even through subsequent legislation.

- Because of this, it is important to ensure that ratepayers receive the absolute lowest financing costs possible for these bonds.
- At last count 24 states allow these securitization offerings. Several states passed securitization legislation in 2019, including Colorado, New Mexico, and Montana.

Subs. for SB 245

There is currently a securitization bill being heard in the Senate Financial Institutions and Insurance Committee. Subs. for SB 245 would give the Commission the authority to oversee and authorize the issuance of ratepayer-backed securitized bonds in order to finance property that is currently included in rate base of an investor-owned utility in the State, or that would otherwise have extraordinary cost impacts to customers if financed through normal ratemaking and financing methods. SB 245 differs from both of the versions of proposed securitization legislation that were debated in the last two legislative sessions. The most significant difference with SB 245 is that the Commission must first approve any electric generator retirement that would lead to an asset that could be securitized. Secondly, this Bill does not contain any restrictions that limit the fuel source of any potential investment that might be made to replace a retired generation resource. This flexibility is important, especially because we are just now beginning to investigate and understand the series of events that led to the load shedding events and rolling blackouts that we experienced throughout SPP and ERCOT during the extreme winter weather events of February 13-16, 2021.

This Bill would allow the following types of costs to be securitized:

- the net book value of property that is currently in rate base and that is no longer used or useful as a result of a Commission-approved decision to retire the generating unit;
- qualified extraordinary costs that would otherwise cause extreme customer rate impacts if recovered through customary rate-making, including, but not limited to, purchases of gas supplies, transportation costs, fuel and purchased power costs, etc. and
- the necessary administrative and operating costs to fund the securitization process.

The Commission Staff (Staff) is supportive of securitization generally, and we are supportive of Subs. for SB 245 (hereafter SB 245) as recently amended. We believe that securitization would be a useful tool for utilities to fund stranded asset costs associated with the early retirement of a generating unit or qualified extraordinary costs such as the extraordinary fuel and purchased power costs associated with the winter weather event experienced last month. Over the last month, we have worked collaboratively with Evergy, the Citizens' Utility Ratepayer Board (CURB), Kansas Industrial Consumers group (KIC), Kansas Gas Service and others to resolve the concerns expressed by some conferees during the last hearing on this Bill before the Senate Financial Institutions and Insurance Committee. While these discussions are ongoing, Staff is optimistic that an agreement will be reached soon that allows all parties to be supportive of this Bill.

Over the last month, the following significant amendments have been made to SB 245:

- A requirement has been added that requires the Commission to address the process for providing ratepayers the benefits of securitization in the predetermination proceeding

pursuant to K.S.A 66-1239, or, those benefits occur simultaneously upon collection of the securitized utility tariff charges.

- Qualified extraordinary costs have been added to list of items that may be securitized.
 - These costs are defined in the Bill as “costs that the public utility has incurred before, on or after the effective date of this act of an extraordinary nature that would cause extreme customer rate impacts if recovered through customary rate-making, including, but not limited to, purchases of gas supplies, transportation costs, fuel and power costs inclusive of carrying charges incurred during anomalous weather events.” This change was added in consultation with stakeholders including Kansas Gas Service and other natural gas distribution utilities. With this change, SB 245 will allow the securitization of any extraordinary cost that would otherwise cause extreme customer rate impacts.
- The name of the securitized bonds has changed from “energy transition bonds” to “securitized utility tariff bonds” to aid in the marketing of the bonds and to more accurately reflect the expanded nature of items eligible for securitization under the amended bill.
- A change to clarify that the allocation of securitized utility tariff charges between customers classes will reflect the allocation of costs decided in the utility’s most recent general rate proceeding. This change was made to accommodate the concerns identified in KIC’s testimony on the Bill before this Committee on February 18, 2021.
- Reinstating provisions 2(d)(13) and (14) that were inadvertently removed during negotiations that led to the original language in SB 245. These provisions pertain to: 1) the utility’s ability to earn a return on any money advanced to fund reserves or capital accounts necessary to effectuate the securitization; and 2) a procedure that matches deferred tax benefits associated with a retired generation asset to the new securitized interest rate instead of the weighted average cost of capital that was previously financing the generating plant.
- Adding a requirement that the Commission must provide for an expiration date, after which the financing order would expire and a utility could no longer issue securitized utility tariff bonds. This provision was added to accommodate stated concerns of KIC in stakeholder discussions.
- A change to provide the Commission with more flexibility to add conditions to the financing order that the Commission deems appropriate, as long as those conditions are not inconsistent with the rest of SB 245.
- Additional technical and clerical corrections necessary to ensure that the mechanics of SB 245 will function as intended and allow for a successful securitization issuance.

While Staff understands that there are additional stakeholder discussions occurring over the next few days, we are confident that this offers the appropriate consumer protections, regulatory review processes, and structural/financial elements so that it would offer a useful tool that will benefit all utility industry stakeholders, if enacted into law. Indeed, in its recent rate study of Kansas electric utility rates, London Economics International (LEI) recommended that the Kansas Legislature pass securitization legislation as an option for how to finance and lessen the rate impact of stranded asset costs or other large capital expenditures.

Independent Studies: Findings on Securitization

Securitization is a not a concept that we have direct experience with in Kansas, as the Commission does not currently have this authority. However securitization has now been authorized in approximately 24 other states in the United States. If done correctly, securitization appears to present the opportunity to lower ratepayer costs while giving the utility certainty that it will be allowed to recover stranded costs created by the early retirement of generation units or other extraordinary utility costs. This tool does appear to provide a rare “win-win,” a feat not easily accomplished in utility regulation.

In its recent rate study, LEI discussed the concept of securitization and recommended it as a tool to finance underutilized and potentially uneconomic coal-fired generating units in the state. LEI stated that securitization is a time and risk allocation process, in which current rates could be lowered by either extending the repayment term of the loan or by achieving lower interest rates than the utility’s costs, and potentially by both. While LEI recognizes the potential of securitization to lower current rates, it also offered the following precautions on pages 215 and 216 of the report:

- **Amortization period, trading lower rates for higher overall payments over time** – as presented in the example in Figure 140, if the interest rate of the ratepayer-backed bond is not low enough, the securitization process would become a tradeoff, as a longer repayment term would lower rates in the short term, but ultimately result in higher costs over time. This outcome could create a fairness issue as future ratepayers who may have never benefited from the securitized asset would have to bear the cost of financing the asset.
- **Regulators would have less control over rates once securitization happens** – in order to secure high credit rating for the ratepayer-backed bonds, regulators would give up control over securitized costs by putting an irrevocable finance order with an automatic adjustment mechanism in force. This means regulators could not influence that portion of the rates through measures such as changing approved WACC or delaying rate cases to suppress rates.
- **The cost of replacing services provided by the securitized asset must be taken into account** – Should the securitized asset be retired, the cost of procuring replacement services (such as energy or capacity provided by a generation asset prior to its retirement) must be taken into account. These costs may, however, be offset by the decrease in operating and maintenance costs of the retired asset. As such, the ultimate cost/benefit analysis of securitization must be performed holistically, taking into account all cost impacts to ratepayers.

Therefore, there are tradeoffs that regulators, electric utilities, and ratepayers should consider before committing to securitization. Staff was cognizant of these tradeoffs during our discussions with Evergy, CURB, KIC and others about this Bill. LEI also provided a detailed review and offered several improvements of a previously proposed Kansas Bill, SB 198. In Staff’s opinion,

SB 245 improves on most, if not all of the criticisms that LEI offered of SB 198. In fact, we considered these criticisms when we negotiated the language that appears in the proposed Bill SB 245.

SB 245 also improves upon the concerns that Staff expressed about SB 198 and SB 437 from the last two legislative sessions. Over the last year, Staff has reviewed in detail the securitization legislation in Colorado, Montana, New Mexico, Florida, West Virginia, and North Carolina. As a result of this detailed review, we are confident that SB 245 will work as intended to produce ratepayer backed bonds that receive the highest credit ratings possible, thereby reducing costs for ratepayers and allowing the utility an opportunity to receive a return of its original capital. Importantly, this tool cannot be used for stranded costs associated with a generation unit unless the Commission approves the asset retirement, which will allow the Commission the opportunity to review the economic and reliability effects of any proposed retirement prior to it occurring. Lastly, the Commission review and due diligence processes in the Bill will ensure that ratepayers receive the lowest possible securitization charges, which will maximize the value ratepayers receive from this financing.

Thank you again for the opportunity to present Staff's overview of securitization generally and some specific testimony regarding Subs. for SB 245.