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Neutral Testimony on Senate Bill 245

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On Behalf of The Staff of the Kansas Corporation Commission

Chair Longbine, 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).

The Commission Staff (Staff) is neutral on SB 245 in its current form; however, <u>we support securitization as a concept</u>. 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. We have worked collaboratively with Evergy and the Citizens' Utility Ratepayer Board (CURB) over the last several months to develop the language in this Bill. With one exception, which I will discuss in detail below, we are satisfied that the Bill 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.

<u>Purpose of the Bill</u>

SB 245 would give the Commission the authority to oversee and authorize the issuance of ratepayer-backed securitized bonds (often referred to as "securitization") in order to finance property that is currently included in rate base of an investor-owned utility in the State. These ratepayer-backed bonds are likely to have higher credit ratings and much lower interest costs than the utility's cost of capital. 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 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; and
- the necessary administrative and operating costs to fund the securitization process.

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, according to a National Regulatory Research Institute (NRRI) article about this subject, securitization has been used in approximately 21 other states in the United States over the last 20 years or so.[1] 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. 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.
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> • **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.
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> • **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

[1]National Regulatory Research Institute (NRRI) Insights series: Managing Electricity Rates Amidst Increasing Capital Expenditures: Is Securitization the Right Tool? An Update, by Joseph S. Fichera, January 2019.

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 and CURB 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 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 <u>in detail</u> 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 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.

<u>Amendment</u>

As discussed above, there is one element of SB 245 that Staff contends is missing from this legislation, which is a requirement that ratepayers receive an immediate rate reduction for the revenue requirement reduction associated with any asset that is retired and securitized. Evergy is aware of Staff's concerns regarding this missing element, and has committed to continue to work on a possible solution with stakeholders.

Accordingly, we have offered the following amendment for the Committee's consideration in the event that this proposed legislation moves forward:

On Page 8, after item (12):

> New (13): A statement requiring the electric public utility, simultaneously with the inception of the issuance of energy transition bonds, reduce its rates through a reduction in base rates or a negative rider on customer bills. This rate reduction shall be in an amount equal to the reduction in the revenue requirement caused by the retirement of any utility electric generating assets and the financing of energy transition costs with energy transition bonds. The revenue requirement reduction shall at a minimum reflect each of the following elements: (1) the return on capital, calculated by multiplying the pre-tax weighted average cost of capital last used to establish the electric public utility's retail rates, by the undepreciated book value of the facility that may become energy transition costs, (2) the return of capital, calculated by summing the depreciation and amortization expense included in the electric public utility's rates directly related to the facility that may

become energy transition costs, and (3) all reductions in non-fuel operating and maintenance expense that can be directly attributed to the retirement of the electric generating facility that may become energy transition costs.

Thank you again for the opportunity to present Staff's testimony regarding SB 245.