



Before the Senate Utilities Committee  
March 12, 2020

Opposition Testimony on Senate Bill 437

Submitted by Justin Grady, Chief of Accounting and Financial Analysis, Utilities Division  
On Behalf of The Staff of the Kansas Corporation Commission

Chair Masterson, Vice Chair Petersen, Ranking Minority Member Francisco, 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) opposes SB 437 in its current form; however, we do not oppose securitization as a concept. To the contrary, we believe that securitization would be a useful tool for utilities and the Commission to fund extraordinary capital projects or stranded costs. 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 unusual capital expenditures. However, LEI also offered several precautionary statements about securitization generally and specific criticisms of SB 198. As detailed below, Staff's review of SB 437 indicates that many of LEI's concerns with SB 198 are relevant to SB 437 as well.

### **Background**

SB 437 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 lower interest costs than the utility's cost of capital. SB 437 differs from SB 198 in that it allows securitization to finance assets that have not yet been retired, although many of the provisions of the Bill still contemplate the retirement of existing baseload generation assets.

The following costs could be securitized as a result of this Bill:

- the net book value of property that is currently in rate base (whether as a result of a retirement or not);
- transition assistance funds for Kansas communities and electric generation facility workers affected by the retirement of these facilities;
- the costs of constructing or acquiring renewable facilities and services, including least-cost generation and other supply-side and demand-side resources; and
- the necessary administrative and operating costs to fund the securitization process.

Securitization is 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.<sup>1</sup> 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.

### **LEI Rate Study Findings on Securitization**

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:

Therefore, there are tradeoffs that regulators, electric utilities, and ratepayers should consider before committing to securitization:

- **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.

In addition to an overview of securitization generally, LEI discussed its specific criticisms of SB

---

<sup>1</sup> See *Attached*—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.

198. SB 347 shares most of the same characteristics of SB 198 that were criticized by LEI. LEI's primary criticism of SB 198 was the limitation placed on the use of the proceeds received by the utility upon issuance of the securitized bonds. These same limitations exist in Section 15 of SB 437. On pages 221 and 222, LEI had the following to say about limiting the proceeds in this fashion:

This limitation in the use of proceeds has the following implications:

1. Even though the value of the asset securitized would be removed from the regulated utility's rate base, the entire value would be reinvested into new rate base assets (except in cases where it is used to support communities impacted by asset retirement). This reduces the ability to "right size" the asset base due to changes in demand outlook and network needs;
2. If the ratepayer-backed bond proceeds cannot be distributed back to investors of the regulated utility, the Kansas utility industry would lock up more capital than without securitization. This may not be the most efficient allocation of capital;
3. The utility would have less incentive to securitize their asset as they have less flexibility in how they want to use the proceeds; and,
4. If the ratepayer-backed bond proceeds are used for the purpose of providing transition assistance to Kansas communities and electric generation facility workers that are directly impacted by the retirement of electric generation facilities, the utility may end up worse off through securitization because the proceeds are neither used to reinvest in new for-profit assets nor are they distributed back to investors – effectively their rate base is reduced without compensation.

LEI's criticisms of Section 15 of this Bill should not be taken lightly. Specifically, outside of a finding of imprudence, reducing the rate base of an electric utility without compensation as discussed in item four above would likely be considered a "takings" in violation of the Just Compensation Clause in the 5<sup>th</sup> Amendment to the U.S. constitution.

LEI also suggested revising SB 198 so that it was not restricted to only securitizing assets that had already been retired. It appears as if many of the revisions to SB 437 have attempted to remove this limitation on the assets that can be securitized, although many of the provisions of the bill do still pertain to the effects of using the Bill to securitize the early retirement of a generating units or units. At a minimum, this apparent inconsistency should be clarified before SB 437 moves forward.

Staff suggests that any securitization bill that moves forward should not contain the kind of restrictions on the utility's use of the securitization proceeds as are contained in Section 15 of SB 437.

#### **Other Staff Concerns with SB 437**

1. Reliability—Staff expressed concern during the hearing on SB 198 last year that the bill

focused too heavily on least-cost generation—a concept which doesn't recognize the broader responsibility of a utility to provide reliable, efficient, and sufficient service. SB 437 does attempt to rectify those concerns by adding language to the bill pertaining to the requirement to provide reliable electric service.

However, the language in SB 437 pertaining to reliability is diminished in priority compared to other requirements. For example, in Section 1(o)(1), on page 4, the only new generation type that can be securitized is “renewable facilities and services, including least-cost electric generating facilities and other supply-side and demand-side resources.” This section makes it clear that only renewable generation resources are allowed to be securitized with the K-EBRA funds. Notably, while the word “renewable” (from SB 198) was replaced with “new cost-effective” facilities on page 1 of SB 437, this restriction still exists on page 4.

Staff suggests that any securitization bill that moves forward should make it clear that reliability and grid stability are absolute priorities during any transition away from traditional baseload generation.

2. Need to Compare SB 437 to Other States—The LEI rate study refers to three case studies in which securitization has been used successfully to reduce utility rates. These examples occurred in the states of Florida, West Virginia and New Orleans. The NRRI article referenced earlier in my testimony also recommends an “active PUC” model like used in the states of Florida, West Virginia, New Jersey, and Texas in order to receive the best results. After the article points out numerous steps that must be followed if securitization is to be a success, it concludes by stating “nothing is automatic in the capital markets; securitization only provides the opportunity to achieve the lowest cost to consumers.” (Emphasis Added)

Staff suggests that the specific roles played in the securitization process by the state PUCs and the legislation that authorized securitization in the states of Florida, West Virginia, New Jersey, New Orleans and Texas, should be fully understood and studied before legislation is passed in Kansas.

This would allow all stakeholders to be confident that they understand best practices and whether any proposed securitization legislation contains such best practices.

3. Other Concerns with SB 437 Language—There are several provisions of SB 437 that Staff suggests should be revised or clarified before this legislation moves forward. For example, Section 4 (11) requires that the final maturity date of the K-EBRA bonds be the “earlier of 30-years from the issue date of the K-EBRA bonds or as late as possible, consistent with obtaining triple A ratings on the K-EBRA bonds while concurrently ensuring that the lowest cost objective is achieved for the K-EBRA bonds.” This language would likely force the maturity of the bonds to be 30-years, instead of a more flexible approach and staggered maturity dates as LEI points out was used in West Virginia and Louisiana. This language should be closely compared with the securitization statutes in these states to see how it could be improved.

Another example is Section 7(d). This section states: “The issuance of the financing bond shall be administered by the Commission.” It is unclear what “financing bond” is being referred to in this section. If this section was meant to refer to the ratepayer-backed securitized bonds themselves, then this section is inconsistent with many other sections of SB 437, which state that the utility will be responsible for the issuance, marketing, and other administration of the securitized bonds.

*Staff suggests that these provisions of this legislation be revised or clarified before this bill moves forward.*

Thank you again for the opportunity to present Staff’s concerns regarding SB 437.