

LATE TESTIMONY

TESTIMONY OF HERMINA MORITA
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DEPARTMENT OF BUDGET AND FINANCE
STATE OF HAWAII
TO THE
HOUSE COMMITTEE ON CONSUMER PROTECTION & COMMERCE

FEBRUARY 8, 2012

MEASURE: H.B. No. 2490 H.D. 1

TITLE: Relating to Electric Utilities

Chair Herkes and Members of the Committee:

DESCRIPTION:

This measure will provide additional assurance of utility recovery of renewable energy power purchase contract costs which would reduce the level of debt imputed by credit rating agencies associated with these contracts and thus improve a utility's credit position and lower overall cost of capital.

POSITION:

The Commission strongly supports this measure, as it will further the State's energy policy, and would like to offer comments for the Committee's consideration.

COMMENTS:

Credit rating agencies view purchased power contracts as long-term debt since utilities have long-term financial payment obligations to renewable energy project developers. As a result, credit rating agencies impute an equivalent amount of debt associated with purchased power contracts when establishing a utility's credit ratings. In response, Hawaii's electric utilities have had to increase the level of common equity in their capital structure to offset the imputed debt in order to maintain the same debt level ratio. The financial and regulatory consequence of the additional common equity is to increase the utility's overall cost of capital and the allowed rate of return, which ultimately raises electric rates for the public. As the number and size of renewable energy projects is expected to significantly increase over the next few decades, so too will the amount of imputed debt that utility will have to offset with additional, expensive equity capital.

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The Commission instituted a power purchase adjustment clause in 2010 through Commission Docket No. 2008-0083, which had the direct effect of reducing the existing imputed debt level of Hawaiian Electric Company, Inc. from 50% to 25%. Ratepayers benefit from electric utilities that are stronger fiscally in the form of ultimately cheaper rates caused by lower costs of capital.

To further improve the imputed debt position of Hawaii's electric utilities, Standard & Poor's rating agency has stated that legislative provisions addressing the recovery of purchased power contract costs provide greater credit rating improvement than solely regulatory action alone. Such legislative provisions are noted as potentially reducing a utility's debt equivalence level to between 0% and 25% of what would have otherwise been imputed without the provision. This measure's proposed language should effectively reduce the imputed debt levels of local electric utilities to a negligible amount, which would remove a significant disincentive for the utilities to seek out and accept renewable energy generation over time. The Commission is concerned that a failure to address the issue of imputed debt, combined with the Hawaii Renewable Portfolio Standard mandate for renewable energy generation that culminates at 40% by the year 2030, will hurt Hawaii's ratepayers by severely limiting the practical fiscal ability of local electric utility companies to support useful levels of renewable energy projects in the State.

The Commission is working to help the State meet its clean energy mandates in a way that pragmatically benefits electric service ratepayers and reasonably assures the health of public utilities. To achieve this end, the Commission has adopted decoupling, a revised integrated resource planning framework, and the investigation of formal, local electric reliability standards. This measure would serve as an additional key function and tool in implementing the State's clean energy policy.

Finally, the Commission has identified and would like to offer clarifying language in the form of an attached proposed House draft for the Committee's consideration.

Thank you for the opportunity to testify on this measure.

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[Proposed HD2]

A BILL FOR AN ACT

RELATING TO ELECTRIC UTILITIES.

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF HAWAII:

1 SECTION 1. The legislature finds that electricity
2 generation projects in Hawaii requiring external financing must
3 typically enter into one or more long-term power purchase
4 agreements with an electric utility before investors will
5 provide such financing. For financial rating agencies that
6 observe and evaluate the effect of these power purchase
7 agreements, including Standard & Poor's, such contracts create
8 fixed, debt-like financial obligations for the electric utility
9 that represent substitutes for debt-financed capital investments
10 in generation capacity. To properly take into account the fixed
11 obligations in a way that reflects the credit exposure that is
12 added by the power purchase agreements, the financial rating
13 agencies represent, or impute, the impact of a power purchase
14 agreement to the contracting electric utility's balance sheet in
15 the form of a new debt obligation. This new obligation is
16 typically referred to as imputed debt or debt equivalence.

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1 Rating agencies may impute to a utility's debt level an
2 amount up to fifty per cent or more of the existing payments on
3 a power purchase agreement, resulting in significant amounts of
4 imputed debt hampering a contracting utility's debt rating and
5 impeding that utility's debt financing. Compensating factors,
6 including legislative provisions for the mitigation of imputed
7 debt on utility companies' balance sheets, are noted as being
8 important variables in either raising or lowering debt
9 equivalence levels. Without an available offsetting mechanism,
10 imputed debt obligations on electric utilities for electricity
11 generation projects can ultimately have a major chilling effect
12 on energy development, especially in states pursuing ambitious
13 renewable energy goals.

14 Reducing the imputed debt obligations of electric utilities
15 can benefit electric utility customers by maximizing the
16 utilities' ability to negotiate low cost, fixed price renewable
17 energy contracts. In addition, the elimination of power
18 purchase agreement-created imputed debt obligations of a utility
19 can lower capital costs for that utility, which helps to
20 mitigate energy costs for consumers through lower rates.

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1 The purpose of this Act is to authorize the public
2 utilities commission to allow electric utilities operating
3 within the State to recover all power purchase costs.

4 SECTION 2. Chapter 269, Hawaii Revised Statutes, is
5 amended by adding a new section to be appropriately designated
6 and to read as follows:

7 "§269- Power purchase agreements; cost recovery for
8 electric utilities. All power purchase costs, including costs
9 related to capacity, operations and maintenance, and other costs
10 that are incurred by an electric utility company, arising out of
11 power purchase agreements that have been approved by the public
12 utilities commission and are binding obligations on the electric
13 utility company shall be allowed to be recovered by the utility
14 from the customer base of the electric utility company through
15 one or more adjustable surcharges, which shall be established by
16 the public utilities commission. Such costs shall be allowed to
17 be recovered if incurred as a result of such agreements unless,
18 after review by the public utilities commission, any such costs
19 are determined by the commission to have been incurred in bad
20 faith, out of waste, out of an abuse of discretion, or in
21 violation of law. An "electric utility company" under this
22 section means a public utility as defined under section 269-1,

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1 for the production, conveyance, transmission, delivery, or
2 furnishing of electric power."

3 SECTION 3. New statutory material is underscored.

4 SECTION 4. This Act shall take effect on July 1, 2012.

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[Proposed HD2]

Report Title:

Debt Equivalence; Imputed Debt; Utility Companies; Cost Recovery

Description:

Authorizes the Public Utilities Commission to allow electric utility companies to recover all power purchase costs from long-term power purchase agreements, thus mitigating associated imputed debt or debt equivalence. Effective July 1, 2012.

(HB2490 HD2)

The summary description of legislation appearing on this page is for informational purposes only and is not legislation or evidence of legislative intent.