TESTIMONY OF HERMINA MORITA
CHAIR, PUBLIC UTILITIES COMMISSION
DEPARTMENT OF BUDGET AND FINANCE
STATE OF HAWAII
TO THE
HOUSE COMMITTEE ON FINANCE

APRIL 3, 2012

MEASURE: S.B. No. 2752, S.D. 1
TITLE: Relating to Electric Utilities

Chair Oshiro and Members of the Committee:

DESCRIPTION:

This measure provides statutory assurance for electric utilities to recover electricity power purchase contract costs in order to reduce the level of debt imputed by credit rating agencies to those electric utilities.

POSITION:

The Commission strongly supports this measure and would like to offer the following comments for the Committee's consideration.

COMMENTS:

Financial rating agencies, like Standard & Poor's, view long-term power purchase contracts as equivalent debt and may impute to an electric utility's debt level an amount of 50% or more of existing payments on a power purchase agreement when analyzing that utility's capital structure. This increases the electric utility's overall cost of capital, because more expensive common equity capital is required to offset the imputed debt.

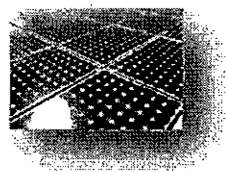
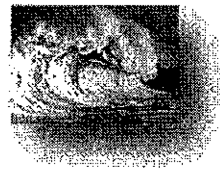
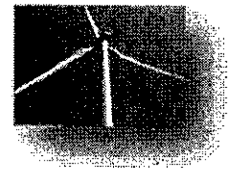
The Commission attempted to address this issue through a specific power purchase surcharge that did partially lower the imputed debt level for electric utilities. However, in examining financial rating agency methodology to calculate imputed debt, it was found that statutory language is preferable to further reduce the level of imputed debt that rating agencies ascribe to these power purchase contracts.

This measure does not create additional ratepayer expense over what is already being charged on monthly electricity bills for power purchase agreements, the cost of which must be found to be reasonable and prudent by the Commission prior to any type of recovery. However, ratepayers benefit when electric utilities' cost of capital is reduced by lower equity requirements, which is the anticipated result of this bill.

Please find attached a fact sheet of frequently asked questions to help address some of the issues concerning this bill.

Thank you for the opportunity to testify on this measure.

blue planet FOUNDATION

HOUSE COMMITTEE ON FINANCE
April 3, 2012, 6:00 P.M.
Room 308
(Testimony is 1 page long)

TESTIMONY IN SUPPORT OF SB 2752 SD1, SUGGESTED AMENDMENT

Chair Oshiro and members of the Finance Committee:

The Blue Planet Foundation supports SB 2752 SD1, a measure which seeks to facilitate greater renewable energy adoption by reducing the level of imputed debt assumed by electric utilities when entering into power purchase agreements.

By enacting this legislation, the State of Hawaii will be telegraphing to financial rating agencies that observe and evaluate the effect of these power purchase agreements, including Standard & Poor's, that the risk and perceived debt equivalence on the electric utilities' balance sheets is minimized.

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

SUGGESTED AMENDMENT

Blue Planet suggest a simple amendment to add further security for the Public Utilities Commission to make the appropriate decisions:

Page 3, line 18, after "violation of law" add "<u>or otherwise deem to be unreasonable and not in the public interest.</u>"

Thank you for the opportunity to testify.

Jeff Mikulina, executive director • jeff@blueplanetfoundation.org
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FREQUENTLY ASKED QUESTIONS

Imputed Debt for Renewable Energy Agreements S.B. 2752 (2012)

What problem does Senate Bill 2752 (Imputed Debt Bill) solve?

When a geothermal power plant, a large solar photovoltaic farm, or a wind farm wants to generate and sell electricity to the public, each project developer must enter into a long-term power purchase contract or agreement (PPA) with one of Hawaii's electric utilities. These PPAs, which must be approved by the PUC, typically last 20 years or more and establish a fixed price that the utility will pay for the developer's electricity over the term of the contract.

Imputed debt (a.k.a. debt equivalence) is an accounting method used by financial rating agencies to transfer the PPA-associated project risk from the renewable energy project developer to the electric utility. This transfer of project risk from the developer to the utility occurs because the utility – the only off-taker of the power generated, given Hawaii's isolation – is now locked into purchasing electricity over the term of the PPA.

Rating agencies treat this transferred risk as a new debt obligation for a utility, and so they "impute" or represent this risk to the utility's balance sheet. The electric utility then has to offset this imputed debt with real equity. Imputed debt can be as much as 50% or more project development costs over the life of a PPA, resulting in substantial debt and offsetting equity on an electric utility's books over long periods of time. As a result, a utility's cost of capital becomes more expensive.

As more and more large-scale renewable energy projects are put into service, the imputed debt associated with such projects will increase, working against the State's renewable energy goals and the financial health of Hawaii's electric utilities.

What does Senate Bill 2752 do?

Senate Bill 2752 seeks to remove from or further reduce imputed debt on an electric utility's balance sheet, along with the corresponding need for more offsetting equity, by ***providing explicit assurance in state law*** that electric utilities entering into long-term power purchase agreements for electricity from renewable energy projects may recover costs associated with such projects, subject to PUC approval.

How does imputed debt currently affect Hawaii's electric utilities?

According to a recent Standard & Poor's report on Hawaiian Electric Company, Inc. (HECO)[1], obligations of long-term PPA costs resulted in imputed debt of $322 million in 2010 to HECO's financial statements. This amount represented a 25% portion or risk factor of possible outstanding PPA-related project obligations at the time of the report.

Why does it matter whether or not imputed debt gets removed from the books of Hawaii's electric utilities?

The more long-term renewable energy PPAs an electric utility enters into, the more imputed debt gets added to that utility's balance sheet. Ultimately, the increased costs of capital will make it very expensive for electric utilities to take on more and more PPAs. Relieving imputed debt obligations through this bill will go a long way to helping maximize Hawaii's renewable energy development without sacrificing the fiscal health of its electric utilities.

[1] Standard & Poor's Research; *Summary: Hawaiian Electric Co. Inc.*; November 21, 2011; page 5.

For questions, please contact the Hawaii Public Utilities Commission at (808) 586-2020

FREQUENTLY ASKED QUESTIONS

Imputed Debt for Renewable Energy Agreements
S.B. 2752 (2012)

How exactly will Senate Bill 2752 remove/lower imputed debt from the books of Hawaii's electric utilities?

The cost recovery assurance Senate Bill 2752 provides is a statutory guarantee of PPA cost recovery, which is viewed by rating agencies as a preferred methodology. This is opposed to regulatory assurances, which has already been provided by the PUC and has resulted in an approximately 25% risk factor reduction. As a result of a statutory guarantee, the imputed debt risk factor could be further reduced for Hawaii's electric utilities to a level near 0% of outstanding renewable energy PPA obligations. Then the imputed debt should not increase as more renewable energy PPAs are signed between Hawaii's electric utilities and clean energy providers.

What will be the cost to Hawaii's electricity ratepayers if imputed debt is reduced for electric utilities?

Nothing. Senate Bill 2752 merely provides the assurance to rating agencies that Hawaii electric utilities may recover all power purchase costs for long-term renewable energy PPAs. This assurance alone should lower the imputed debt risk factor and reduce the utilities' debt levels. No new surcharge is required.

However, removing imputed debt from an electric utility's books should lower its equity requirements and thus reduce its cost of capital. This reduced cost could result in savings for the electricity ratepayer.

HREA
HAWAII RENEWABLE ENERGY ALLIANCE

TESTIMONY OF WARREN BOLLMEIER ON BEHALF OF THE HAWAII RENEWABLE ENERGY ALLIANCE BEFORE THE HOUSE COMMITTEE ON FINANCE

SB 2752 SD1, RELATING TO ELECTRICITY

April 3, 2012

Chair Oshiro, Vice-Chair Lee and members of the Committee I am Warren Bollmeier, testifying on behalf of the Hawaii Renewable Energy Alliance (HREA). HREA is an industry-based, nonprofit corporation in Hawaii established in 1995. Our mission is to support, through education and advocacy, the use of renewables for a sustainable, energy-efficient, environmentally-friendly, economically- sound future for Hawaii. One of our goals is to support appropriate policy changes in state and local government, the Public Utilities Commission and the electric utilities to encourage increased use of renewables in Hawaii.

The purpose of HB 2752 SD1 is to authorize the Public Utilities Commission to allow electric utility companies to recover all power purchase costs that have been approved by the Commission.

HREA **supports** this measure as it supports the state's overall clean energy objectives, and we offer the following comments in support:

1) While seemingly just a "housekeeping" measure, it will help correct the long-standing view on "Wall Street" that Independent Power Purchase Contracts create an imputed debt on the utility's balance sheet, and this is well explained in Section 1 of the measure. In short, the utility is guaranteed that it will be reimbursed for the cost of its Power Purchase Agreements and this helps keep its "borrowing costs" from increasing, and

2) The net increase of the utility's debt has another impact related to the utility's desired debt-to-equity ratio. Specifically, in order to maintain the utility's desired debt-to-equity ratio, with the imputed debt, the utility would need to issue more shares. That in turn, increases the utility's "cost of doing business" and thus can contribute to higher utility rates. Without the imputed debt, no additional equity is required.

Thank you for this opportunity to testify

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Testimony Before The House Committee on Finance

Senate Bill No. 2752, SD1

Tuesday, April 3, 2012
Agenda #2, 3:00 pm

By
Lorie Ann Nagata
Treasurer
Hawaiian Electric Company, Inc.
Hawaii Electric Light Company, Inc.
Maui Electric Company, Limited

Chair Oshiro, Vice Chair Lee and Members of the Committee:

Hawaiian Electric Company, Inc., Maui Electric Company, Limited and Hawaii Electric Light Company, Inc. ("Companies") strongly support the passage of Senate Bill No. 2752, SD1. This bill authorizes the Public Utilities Commission of the State of Hawaii ("Commission") to distribute all costs arising out of power purchase agreements between an electric utility company and non-utility generators of electricity that have been approved by the Commission. These costs would be distributed among the entire customer base through an adjustable surcharge which shall be established by the Commission.

Presently in analyzing the Companies, the credit rating agencies impute debt for their independent power producer ("IPP") contracts. IPP contracts create debt-like obligations that represent substitutes for debt-financed capital investments in generation capacity. The rating agencies impute debt to the Companies because of this. The legislation may result in a reduction of the level of debt imputation for the Companies' off-balance-sheet purchased power obligations by the rating agencies. A reduction in the imputed debt would help to enhance the Companies' financial profile and help to enhance the Companies' credit ratings. Standard and Poor's presently rates the Companies at BBB-, which is just one notch above "non-investment" grade or "junk" bond status.

Credit ratings are important as they are a measure of credit risk and have an impact on the cost of capital to the Companies and could affect the cost of purchased power contracts. These costs ultimately impact the cost of electricity to customers, as the costs of financing and purchased power generally are recoverable in customers' rates.

As the Companies enter into more IPP contracts for renewable energy in support of the renewable portfolio standards imputed debt will be expected to increase. Competitive bidding requirements for new generation may also result in more IPP contracts. The percentage of net KWH purchased from IPPs in 2011 was 40% for the Companies. This is forecast to increase to 48% by 2016.

This bill could help reduce the debt imputed by the rating agencies in their analysis of the Companies. That would enhance the financial strength and credit ratings of the utilities and therefore benefit the electric utility customers.

Thank you for the opportunity to testify in support of this measure.