

# SB 2752

Measure Title: RELATING TO ELECTRIC UTILITIES.

Report Title: Debt Equivalence; Imputed Debt; Utility Companies; Cost Recovery

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

Companion: HB2490

Package: Gov

Current Referral: CPN, WAM

Introducer(s): TSUTSUI (BR)

<b>Sort by Date</b>		<b>Status Text</b>
1/25/2012	S	Introduced.
1/25/2012	S	Passed First Reading.
1/25/2012	S	Referred to CPN, WAM.
1/27/2012	S	The committee(s) on CPN added the measure to the public hearing scheduled on 01-31-12 9:00AM in conference room 229.

TESTIMONY OF HERMINA MORITA  
CHAIR, PUBLIC UTILITIES COMMISSION  
DEPARTMENT OF BUDGET AND FINANCE  
STATE OF HAWAII  
TO THE  
SENATE COMMITTEE ON COMMERCE & CONSUMER PROTECTION  
JANUARY 31, 2012

**MEASURE:** S.B. No. 2752

**TITLE:** Relating to Electric Utilities

Chair Baker 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 input 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.

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.

S.B. NO. 2752 SD1  
[Proposed]

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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  
8 represent the transfer of business viability risk assumption  
9 from the project developer to the electric utility. To properly  
10 calculate a contracting utility's new level of debt-related  
11 risk, this transfer of risk assumption further causes the  
12 financial rating agencies to represent, or impute, the impact of  
13 a power purchase agreement to the contracting electric utility's  
14 balance sheet in the form of a new debt obligation. This new  
15 obligation is typically referred to as imputed debt or debt  
16 equivalence.

# S.B. NO. 2752 SD1

[Proposed]

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.

S.B. NO. 2752 SD1  
[Proposed]

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 non-energy 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,

S.B. NO. 2752 SD1  
[Proposed]

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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INTRODUCED BY: \_\_\_\_\_

8

BY REQUEST

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# S.B. NO. 2752 SD1

[Proposed]

**Report Title:**

Debt Equivalence; Imputed Debt; Utility Companies; Cost Recovery

**Description:**

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

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



**Testimony Before The Senate Committee On  
Commerce and Consumer Protection**

**Senate Bill No. 2752**

January 31, 2012

By

Lorie Ann Nagata

Treasurer

Hawaiian Electric Company, Inc.

Hawaii Electric Light Company, Inc.

Maui Electric Company, Limited

Chair Baker, Vice Chair Taniguchi 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 with a suggested amendment. This bill authorizes the Public Utilities Commission of the State of Hawaii ("Commission") to distribute all non-energy 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 2010 was 40% for the Companies. This is forecast to increase to 50% by 2015.

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.

We would like to request the following amendment to the second and third sentences of section 1, starting on page 1, line 5 (suggested insertions underlined and deletions struck out) which clarifies the effect of IPP contracts from the rating agency perspective and their reason for imputing debt:

"For financial rating agencies that observe and evaluate the effect of these power purchase agreements, including Standard & Poor's, such contracts create fixed, debt-like, financial obligations for the electric utility that represent substitutes for debt-financed capital investments in generation capacity ~~represent the transfer of business viability risk assumption from the project developer to the electric utility.~~ To properly take into account the fixed obligations in a way that reflects the credit exposure that is added by the power purchase agreements ~~calculate a contracting utility's new level of debt related risk,~~ this transfer of risk assumption further ~~causes the financial rating agencies to represent, or impute, the impact of a power purchase agreement to the contracting electric utility's balance sheet in the form of a new debt obligation.~~"

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

Testimony for CPN 1/31/2012 9:00:00 AM SB2752

Conference room: 229

Testifier position: Oppose

Testifier will be present: No

Submitted by: Friends of Lana'i

Organization: Friends of Lana'i

E-mail: [friendsoflanai@gmail.com](mailto:friendsoflanai@gmail.com)

Submitted on: 1/30/2012

Comments:

Aloha:

We are writing to OPPOSE SB2752.

As part of the Governor's package, this bill, rather than promote a rational state energy policy, appears aimed at insuring benefit for a shareholder-owned utility at the expense of its ratepayers. It is very dangerous to permit "all costs" to be recovered without clearly defining terms:

~ If Hawaii's "ambitious renewable energy goals" are problematic for the credit rating of the monopolistic utility of our state, perhaps it should lobby this body for a roll-back of the renewable portfolio standards (rps). Many mainland states are taking this sep after finding a rush to "get there first" is unrealistic and injures ratepayers.

~ "Costs," "bad faith," "waste," and "abuse of discretion" must be clearly defined.

~ Distributing unidentified "costs" among unidentified "entire customer base[s]" is unclear and could prove inequitable.

~ An "adjustable surcharge," without indicating a basis for "adjustment," is impermissibly vague.

~ Precisely how "eliminating" power purchase agreement-related "imputed debt obligations" of the shareholder-owned utility would "lower capital costs" is unclear.

Please kill this bill.

Mahalo for your consideration.

**SENATE COMMITTEE ON COMMERCE AND CONSUMER PROTECTION**

Attention: Rosalyn Baker, Chair  
Opposition to SB 2752, Relating To Cost Recovery  
Hearing January 31, 2012, 9 a.m.

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Aloha kakou:

I am writing to **OPPOSE** SB2752.

This measure is inexplicably part of the Governor's package: rather than promote state policy and protect consumers, it appears aimed to insure benefit for a shareholder-owned utility at the expense of its ratepayers. It is very dangerous to permit "all costs" to be recovered without enumerating what they might entail.

- Costs must be defined.
- Distributing unidentified "costs" among unidentified "entire customer base[s]" is unclear and could prove inequitable.
- "Bad faith" and "waste" and "abuse of discretion" are not defined.
- An "adjustable surcharge," without indicating a basis for "adjustment," is impermissibly vague.
- Precisely how "eliminating" power purchase agreement-related "imputed debt obligations" of the shareholder-owned utility would "lower capital costs" is unclear.
- If the "ambitious renewable energy goals" are problematic for the credit rating of the monopolistic utility of our state, perhaps it should lobby this body for a roll-back of the renewable portfolio standards; many mainland states are taking this step after finding the rush to "get there first" was unrealistic and injurious to ratepayers.

Please kill this bill.

Conference room: 229  
Testifier position: Oppose  
Testifier will be present: No  
Submitted by: sally kaye  
Organization: Individual  
E-mail: [skaye@runbox.com](mailto:skaye@runbox.com)  
Submitted on: 1/30/2012