Using Securitization to Unlocking Benefits for Customers, Utilities, and the State Economy

Many regulated utilities own aging power plants that are more costly to keep up and running than building and running newer, cleaner plants. Retiring such costly older power plants sooner than later and replacing them with the newer plants could lead to lower electricity prices for Missouri families and businesses. But realizing these benefits is challenging because of the real, near-term costs of early retirement – including possible short-term spikes in electricity costs, displaced workers, impact on local economies, and reduced earnings and growth prospects for utilities. We propose using a proven, low-risk, financing tool – ratepayer-backed bond securitization – to address these issues without the use of any state or local tax or bonding authority. Securitization can help make clean energy work for everyone by enabling immediate electricity cost savings from early plant retirement, funding assistance to impacted communities and workers, and allowing utilities to create jobs and economic growth in Missouri by reinvesting its capital in newer, cleaner, and more profitable generation.

Why is replacing uneconomic power plants so challenging? In case of a regulated utility, customers pay for a power plant as if they are repaying a loan for the plant. The customer must compensate the utility for:

1) **Operating Costs –** covers expenses the utility incurs in running the plant – such as fuel costs, any costs involved in operating plant including taxes, worker wages, and worker benefits, and any costs for routine plant maintenance,
2) **Return of Capital or Depreciation (principal repayments) –** compensates the utility over time for any investment the utility has made in the plant, akin to principal re-payments on a loan, and
3) **Return on Capital (interest payments) –** provides the utility an allowed fair return on any outstanding balance of capital that the utility hasn't yet been repaid, much like the interest payments on the outstanding principal balance on a loan. However, the rate of return is generally much higher for a utility (10-11%) than it is for a typical loan (4-5%).

If the plant is retired early:

1) **Operating costs fall, saving ratepayers money but taking local jobs and tax revenues with it** – if the electricity generated by the old plant is replaced by cheaper clean energy, ratepayers can save money. However, this can hurt workers whose jobs have disappeared and local communities that see their tax revenues drop unexpectedly.
2) **Depreciation expenses can increase sharply** – early plant retirement is often treated by regulators a lot like early repayment of a loan, with more rapid repayment of principal balances in lump sums that can create a spike in customer costs. This can be done by rapid depreciation either just before or after the plant is retired
3) **Future utility returns fall** – with the early return of their capital, the utility will see an erosion of future returns on capital, and therefore future earnings. Further, if the utility continues to recover its invested capital after the plant has retired, it faces additional risk that its regulators may decide to lower its return on any outstanding balances as the plant isn't providing ratepayers any benefits.

Together, these potential near-term consequences can discourage utilities and regulators from taking advantage of new clean generation, particularly when demand for electricity is flat or falling.

What is securitization? Securitization is essentially a lower cost, long-term loan that ratepayers take out and pledge to repay using a portion of their future electricity bills which can replace – or refinance – the expensive,

short-term utility financing for an asset that is retired early. Specifically, it can be used to replace the rapid return of capital (over 4-7 years) and the high return on that capital (10-11%) for a plant that is retired early with a cheap (3% "interest rate"), long-term (15-20 year) bond that can save customers money in the long run. And just as one can use a home refinancing to take out a bigger loan than you need to repay the old loan, proceeds from securitization in excess of that needed to pay back the utility can be used to finance solutions to other challenges with early plant retirement.

How can securitization help make clean energy work for everyone? The proceeds from securitization can pay for measures to address the short term challenges of early plant retirement including:

1. **Local Impact Assistance and Worker Support:** Bridge funding to help smooth the impact of plant closures on local tax bases can help local stakeholders focus on long-term economic adjustment instead of immediate fiscal crisis. Workers at retired plants can be supported through early retirement benefits, retraining assistance or transfer to a different facility.
2. **Lower Electricity Costs for Missouri Businesses and Families:** Since securitization basically replaces an expensive, short-term loan with a cheap, long-term loan, it can both reduce electricity costs in the near term (because of lower principal and interest payments), and in the long term (because of lower overall interest rates). Further, a portion of the funds generated by securitization may be allocated to support energy efficiency – that can further bring down electricity costs.
3. **Provide Capital to Invest in Modernizing Missouri's Electricity System:** The capital returned to the utility can be reinvested by the company to modernize Missouri's electricity system. One particularly attractive way to do so would be for the utility to take advantage of federal tax credits expiring over the next few years to build cheap wind and solar energy. In effect, using securitization to finance assets that benefit from tax incentives can help Missouri capture federal taxpayer dollars and put them to work adding good jobs that can make the state more competitive and meet the renewable demand for large companies.

What does Missouri have to do to take advantage of securitization? To use securitization, Missouri's legislature must pass a bill that allows the Missouri Public Service Commission to take the following steps:

1) Create a dedicated, non-bypassable charge on customer bills for the next 15-20 years whose sole purpose is to make fixed payments on a bond.
2) Create a new company whose sole asset is the rights to the revenues from this charge, and whose sole purpose is to issue a low-cost bond to be repaid by those revenues. Note that this bond is similar to a corporate bond, and is not a state or municipal bond.
3) Use the proceeds from the bond issuance to address the challenges above, for example, by immediately returning any unrecovered historical investment in a plant to the utility.

Specific retirements will still need to be approved by the regulator, so securitization does not force the closure of any plants. It simply provides the utility and regulators with another tool for providing customers least-cost service while maintaining the utility's financial ratings.

Securitization has been a valuable financial tool for utilities for decades, helping to remove billions of dollars of stranded and regulatory assets from rate base and ease rate shocks from natural disasters. In just one example, last year, Duke Energy saved its customers over $700 million dollars through the refinancing of $1.3 billion of a nuclear plant in Florida at an interest rate of only 2.72%. Legislation allowing for securitization exists in 20 states, and is under review in at least one other. In Missouri, it could help replace up to 7500 MW of uneconomic coal plants with cleaner, cheaper plants.