

# Quitting coal

An uptick in utility ABS is expected as US utilities seek financial solutions for retiring the country's aging fossil fuel fleet. **Claudia Lewis** explores how the proceeds from these transactions can be used to facilitate an equitable energy transition.

**U**tility ABS may be set for revival in the US as a means of funding the 'just' energy transition, as consumer concerns over rising energy costs reignite the coal question. With wind and solar energy now the cheapest sources of energy generation in most parts of the world, securitisation is being increasingly considered as a uniquely adept funding solution for decommissioning coal plants – financially benefitting the utilities, surrounding communities and consumers nationwide.

"Securitisation bonds provide immediate, up-front capital, some of which can be allocated toward funding that alleviates the impact of this transition," explains Christian Fong, senior associate and member of the Utility Transition Finance team within the Rocky Mountain Institute's Carbon-Free Electricity programme.

Utility ABS allows utilities to refinance the debt issued initially to build the plants by taking out low-interest bonds to pay off the remaining coal investment – despite having several years of operational life left – with additional funds left over to invest in developing replacement renewables capacity. Fong adds: "Some of the bond funding could also be used to fund remediation and clean-up of polluted sites, like toxic coal ash waste ponds, coal mines and stripped lands, as well as other unknown environmental liabilities."

Since the end of the last century, utility-led securitisation transactions have been focused on transition when electricity generation competition ▶



Christian Fong, Rocky Mountain Institute

and stranded assets utilities are involved, as securitisation bonds compensate and recover these stranded costs. “Utility ABS can help pull forward that transition. Because these securitisations have strong guarantees of repayment through state legislative requirements and are placed in bankruptcy-remote SPVs, these bonds garner triple-A ratings, providing extremely low-cost capital (with interest rates usually anywhere from 2%-4%),” explains Fong.

He continues: “Compare this to the normal utility-approved rate of return, which ranges anywhere from 7%-10% typically. These lower interest rates, along with long bond tenors (this can range anywhere from 10 years up to 30 years), makes utility ABS an extremely low-cost alternative to business-as-usual cases, with the additional benefit of accelerating the build-out of clean energy.”

Even with interest rates currently sitting between 3%-5% following sharp increases over the last 18 months, the savings from securitisation are likely to remain similar in magnitude, due to the universal impact of increased interest rates on other debt financing methods used by utilities, including corporate debt.

A ‘just’ transition for coal-reliant communities is understood to follow a three-step framework, covering relief, reclamation and reinvestment. This would include reducing pollution risks and supporting the coal workers and local communities in the immediate term with financial relief, and in the medium term with job-creation at old sites, as well as reinvestment to support economic diversification and resilience.

Fong emphasises: “A just transition for the coal industry in the US is one that does not simply abandon the communities, workers and towns that have supported and powered the economic growth of this country over the past century.”

Since 2019, more than 20 US states have legislated the securitisation of utilities. Michigan, New Mexico and Wisconsin have all secured regulatory approval for coal plant securitisation, applications are active for Indiana and Missouri,

and plans are being drawn up in both Colorado and North Carolina. Already, some of this emerging state-level utility ABS regulation requires ‘just’ caveats – such as the formation of replacement renewable projects, having to rebuild said project in the same community as the old power plant, continue to benefit the community from investment, employment and so on.

While very few utility ABS transactions have been publicly marketed thus far, completed investor-owned utility securitisations of ratepayer-backed bonds include the 2021 triple-A rated Wisconsin Electric Power Company WEPCO Environmental Trust I, the 2022 DTE Electric Securitisation I in Michigan and the US\$341m CenterPoint deal in Indiana. Pending issuances include two deals from Michigan Consumer Energy – one US\$688m deal scheduled for this year and the other US\$601.6m approved in June – and one US\$360m deal from the Public Service of New Mexico, approved in April 2020, which remained in litigation until August of this year.

Service Company of New Mexico’s decision to drop its State Supreme Court Appeal last month and agreement to issue delayed rate credits, customers are also expected to see monthly utility bill savings averaging 11%.

“They’ve made quite a conscious effort, and I think that is an example of success,” states Lehr. “But it’s not as widespread as I’d like to see – and, of course, the underlying rate of coal plant retirements is not as fast as it needs to be.”

The inclusion of atypical caveats supporting the energy transition is increasing across the US as state securitisation regulations evolve. The novel application of environmental accountability within financial tools is propelled by campaigning from non-profit organisations like New Energy Economics, where Lehr serves as board chair.

Indeed, not all public policy will necessarily require replacement capacity for renewables, and in some cases ‘replacement’ may only be to slightly cleaner fuel sources – as seen in some cases naming natural gas applied power generation.

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## “THESE SECURITISATIONS HAVE STRONG GUARANTEES OF REPAYMENT THROUGH STATE LEGISLATIVE REQUIREMENTS AND ARE PLACED IN BANKRUPTCY-REMOTE SPVS, THESE BONDS GARNER TRIPLE-A RATINGS”

Colorado, Missouri and New Mexico are chief among those states seeking to use utility ABS to support a ‘just’ transition. Clean energy consultant and attorney, Ronald Lehr, considers the first coupling of the pursuit of a ‘just’ transition and the retiring of coal plants to be in Colorado legislation, and with the public policy design surrounding the closure of the first two units of the Comanche Plant.

Colorado law requires the new funds in part go towards retraining workers from the decommissioned power plant, while the utility ABS statute in New Mexico established the “energy transition displaced worker assistance fund” and other provisions to support displaced workers and communities.

The New Mexico case is widely regarded as a successful pairing of utility ABS with ‘just’ caveats – with utility securitisation legislation steering development back into San Juan County’s school districts and jobs. Indeed, following the Public

William Attwell, Sustainable Fitch climate and sustainable finance research director, confirms: “There is a huge amount of variation. But given the number of pieces of legislation that have been adopted or are in the pipeline across the US, it seems like an approach that is likely to expand.”

The dilemma with public policy is not only in securing ‘just’ requirements, but also in getting the utilities on board in the first place. Fong warns: “Without any smart policies or financial tools, it actually may be cheapest for the utility to wait for another decade for the coal plant’s natural retirement date. Securitisation transactions and legislation must be carefully designed to ensure the highest possible benefit for utility ratepayers. Additionally, in order to build durable constituencies supportive of the clean energy transition, we must incorporate elements of a ‘just’ transition that supports coal communities as coal rapidly declines.”



William Attwell, Sustainable Fitch

Monetary motivation is crucial for empowering utilities and ratepayers to embrace and pursue the transition to cleaner energy – ‘just’ or not. Unpaid investment presents a large hurdle in getting utilities to retire their most costly fossil fleet – and indeed replace it with renewables – and utilities would need to see their investment capital returned first.

“Obviously, there is compensation for investors, and the question is how far can this decommissioning be financed in a way that means both ratepayers and investors aren’t unfairly penalised,” explains Attwell.

However, it is not just the ratepayers. The utilities themselves remain divided on the benefits of securitisation, as many feel entitled to the equity lost on the remaining expected years of use from early plant retirement scenarios.

“Some consumer advocates see securitisation as an automatic guarantee for utilities to recover their sunk capital, while some utilities see securitisation as a method that reduces profits,” notes Fong.

In the case of the Arizona Public Service Company, for example, there was much resistance to calls to make the energy transition in the tribal lands. “It’s just not in their mental picture – they don’t see why they would contribute further to community and worker support after they have paid so much money in taxes, wages and benefits to the tribal people for so long,” comments Lehr.

Unlike many other environmental challenges in the US, the use of securitisation for decommissioning coal plants is less politically fraught, given the prevalence of coal plants in rural – and often Republican – states. Instead, the emphasis is on the social and financial aspects of the issue. Indeed, this is exemplified in the historical swing-state of Michigan, where half of the six recent securitisation efforts aimed at recovering stranded costs from coal plant retirements have taken place.

“People really haven’t realised that there has been a fundamental shift in the economics that should cause a lot of change, and quite rapidly,”

explains Lehr. “But the utility sector isn’t characterised by fast action in most respects.”

Retirement is inevitable. More coal plant retirements are expected in the US than anywhere else, with more than 110,000 megawatts of coal utility infrastructure scheduled to be decommissioned between now and 2040.

“The data also points to them being retired younger too, with the average age of retirement falling to around 48 years, from 56 years back in 2015,” adds Attwell.

The financial benefits of utility ABS for consumers have already been proven. According to RMI research, through the securitisation of the recently retired Georgia Power coal plant, customers could save more than US\$1bn.

new clean energy as their new profit driver, which can increase their profits via a higher ratebase and improve credit metrics through higher near-term earnings,” Fong explains.

In fact, harnessing utility ABS as a ‘just’ transition funding strategy does appear possible. “It looks like the direction of travel is towards more states adopting these enabling laws – and part of that is just that it makes economic sense,” adds Attwell.

However, establishing a cleaner energy infrastructure will be a slow process due to reliability concerns, according to continued analysis from New Energy Economics.

Going forward, comparative equity analysis or fairness analysis may provide a basis for

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The consideration of lowering costs for consumers was considered an important argument backing Consumers Power Michigan’s securitisation activities. Wind energy generation is cheaper too – as the non-profit Catalyst Cooperative’s Public Utility Data Liberation project, ‘PUDL’, found through an analysis of SEC and grid data. The study concluded that the cost of wind per megawatt hour is just US\$10 for one competitively acquire wind plant – compared to US\$25 for public coal plants in Colorado.

As Fong explains: “Ensuring that securitisations are executed at the lowest possible cost and provide the highest amount of savings to ratepayers, as well as making the utility pay for financial counsel to advise regulators, among other provisions, can help ensure that customers receive the highest possible benefits. And regulators should be aware if securitisation is a viable option in their state and ensure any cost analyses also look at the potential savings from securitisation to accelerate the clean energy transition.”

With more closures on the way, many believe that securitisation offers an all-in-one resolution to the issues of expense for coal plant retirement, and lead to higher profits long-term via new clean energy investments and improved credit metrics. “Rather than relying on a declining ratebase of nearly depreciated coal plants, they can essentially swap out that coal plant as a profit driver to

quantifying the financial benefits of securitising coal utilities’ unpaid facility debts with ‘just’ transition features, according to Lehr, as seen in a filing from the Navajo Nation at the Arizona Corporation Commission during the debate over the issue of the Navajo generating station. “As a lawyer, in the courts we talk about equity being fairness; an equivalency of claims as among contesting parties,” he explains. “Is there rough equity or fairness between companies who’ve used these communities to get the energy that they’ve sold, what they’ve put in, their profits taken out, and what the communities and workers now face at retirement of those facilities?”

An uptick in utility ABS is expected as US utilities seek financial solutions for retiring its aging fossil fuel fleet. However, whether the proceeds from these securitisation transactions will be used to facilitate a fair and equitable transition remains to be seen – and will depend on local legislation.

“Ensuring a ‘just’ transition is a complicated, multi-faceted issue. Securitisation can help with this, but it is not sufficient alone,” Fong concludes. ▶

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