Community Finance Brief

Legal Concerns for Power Utilities in Light of Energy Transition

Court Street Group

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Risk to large power providers in the United States may be taking on new dimensions as advocates for climate change action begin to see their labors come to light. The structure of power generation and distribution in this country is monopolistic in nature (albeit less so compared to most other developed countries) and that very structure could see unexpected risks in new forms of litigation that is arising as climate-related change takes place.

A new twist in an ongoing antitrust case in Hawai'i points to an unlawful termination of a power purchase agreement (PPA) by Hawai'i Electric Light Company (HELCO) to Hu Honua Bioenergy, LLC slated to be part of the state's renewable energy transition that it also led to an overgrowth in grasses that is directly tied to the recent wildfires in Maui.

This lawsuit is a real-time example of the intersection of climate risk factors, power providers (both investor-owned and public) and their increased susceptibility to liabilities as the nation transitions to more renewable energy. These liabilities stem from the dynamic of monopolistic provider structures many states have in this country converging with policy makers pushing forward plans for a less fossil fuels reliant system that will inevitably butt heads with power grid status quo. This angle on the energy transition has not been covered as extensively as other aspects and stakeholders in the energy sector and all communities should consider the Hawai'i case as a bit of a canary. The outcome is not expected to set precedents but could pave a way for potential outcomes elsewhere.

FROM EDISON TO HELCO, BRIEFLY

The structure of power providers in the U.S. has a rich legal and regulatory history to it and is integral to understanding the issue that has been raised. In the late 19th and early 20th centuries electricity generation was a new and complex

Quick Takes

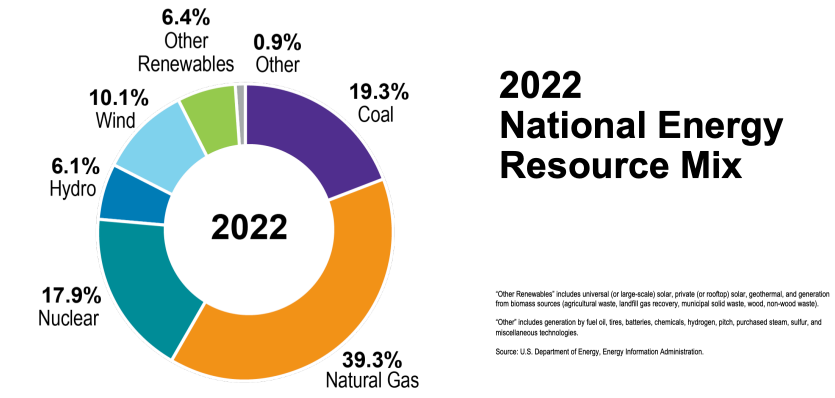
Roughly 200 **privately owned utility** companies provide between 70% and 75% of all electricity to Americans in 2022
– *Edison Electric Institute*

In 2017, there were 16-times as many public-owned or cooperative companies as there were investor-owned while these private companies provided electricity to **72%** of all people in the country
– *U.S. Energy Information Administration*

In 2008, 9% of all energy generation in the United States was the result of **renewables resources**, which doubled by 2018
– Bloomberg New Energy Finance

Electric utilities account for about 4%-5% of annual municipal bond issues, or about **$11 billion** each year over the last decade
– Refinitiv

Hawaii Electric long-term municipal bond ratings **were cut** to Baa3/B-minus/B in August this year post-Maui wildfires



technology that required the building and maintaining of new infrastructure that was expensive and needed significant investment. The first distribution system was built in1882 in Manhattan and New Jersey as direct current while the first alternate current line connected Niagara Falls to Buffalo in 1907. In this nascent stage, most power grids were locally owned and operated by governments and in many cases funded by municipal bonds. Kansas City (1888), Jacksonville (1890) and Los Angeles (1895) are some of the first documented muni bond issues for electric grids.

As the technology matured leading into World War I, private investors saw the opportunity and began to acquire existing grids or build new ones, often through private funding and this led to a broader power shift towards private ownership and operation of many girls in the U.S. It was during this period that regulatory compacts were formed in the name of creating stable and predicative business environmental for the newly emerging electric power industry. In this agreements, utilities were granted exclusive rights to operate in specific geographic areas and state governments established regulatory commission to set rates that utilities could charge.

"The year 2030 is not the end of our energy road, so we must snore that today's energy decisions are being made with the appropriate long-term considerations," said Blue Planet Executive Director **Jeff Mikulina,** referring to the state's existing target of 40% renewable energy generation by 2030. "This policy aligns today's energy decisions with tomorrow' energy system. It will ensure that the plans and investments we make now do not lock us into an inflexible energy paradigm that will persist long after 2030 passes. By setting a 100% target today, we can create and implement solutions that will go the distance to achieve energy independence."

The energy crisis in the 1970s led to some decentralization of the U.S. energy complex. The Energy Policy and Conservation Act of 1975 and the Public Utility Regulatory Policies Act of 1978 served as turning points in energy policy that put an emphasis away from fossil fuels and energy efficiency for the first time in U.S. history and also laid out a more stringent regulatory regime over the industry that did allow for more purchasing of power from competitors of compact monopolies.

HELCO is essentially an example of a regulatory compact given that it has been granted a franchise by the state to provide electric service as a monopoly, it is regulated by the Hawaii Public Utilities Commission as far as rates it can charge and has an obligation to serve, meaning it must provide electric service to anyone who requests it regardless of cost or location.

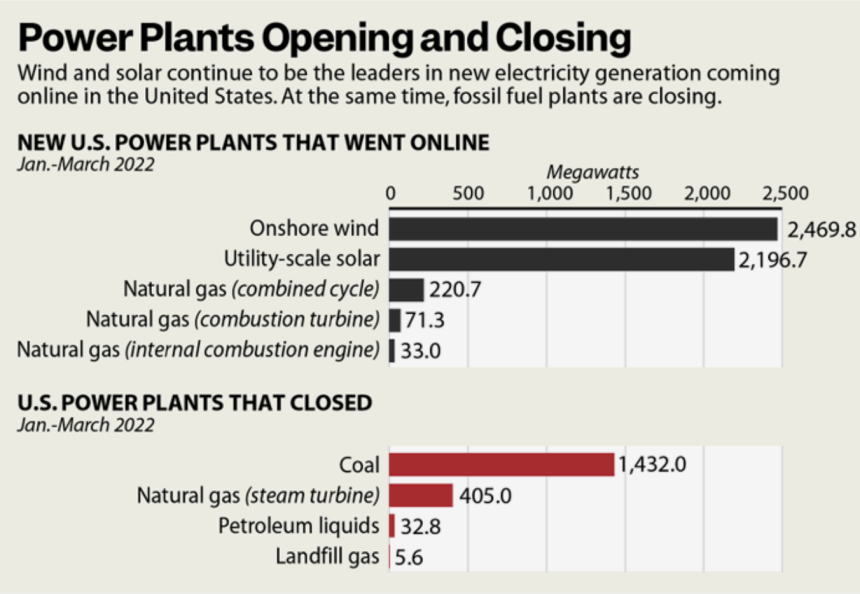
THE CURRENT ENERGY COMPLEX & POLICY CONUNDRUM

"Nationwide, we are flipping the switch for an equitable clean energy transition: one community at a time," said U.S. Secretary of Energy **Jennifer M. Granholm**. "We are empowering states and their local governments - that know their needs best - to implement ambitious plans to transform their communities and ensure no one is left behind."

The energy transition in the U.S. has accelerated under the current Administration and this poses greater legal liabilities to the status quo. Before going into the specifics, there is a structural conflict here as the infrastructure is transitioning beyond the way the current grid exists. The legacy compacts are built on the foundation of fossil fuel power generation and distribution. While novel technologies can certainly be developed and maintained by existing compacts, the transition will force new power brokers into the mix. HELCO's situation with Hu Honua is the result of the Hawai'i State Renewable Portfolio Standard that has specific renewable energy quotes in place to support energy transition policy goals.

The Biden administration has implemented several policy changes that may *specifically* challenge the dominance of power provider monopolies:

- Executive Order on Promoting Competition in the American Economy: This order directs federal agencies to review and revise regulations that limit competition in various industries, including the energy sector. This could lead to policies that encourage the entry of new competitors into the market and challenge the monopolies of existing power providers;
- Federal Infrastructure Investment and Jobs Act: This law includes provisions aimed at promoting competition in the electric power sector, such as funding for grid modernization and clean energy technologies. This could create new opportunities for independent power producers and distributed generation, ultimately reducing reliance on traditional monopolies; and specifically on,
- Department of Energy (DOE) focus on grid resilience: The DOE is investing in programs to improve the reliability and resilience of the electric grid, including cybersecurity measures and distributed generation. This could make the grid less vulnerable to outages and disruptions caused by extreme weather events or cyberattacks, potentially reducing the dependence on large, centralized power providers; and
- Department of Justice (DOJ) enforcement of environmental regulations: The DOJ has increased its enforcement of environmental regulations, including those aimed at reducing



greenhouse gas emissions from power plants. This could expose power providers to legal liabilities for failing to comply with environmental standards.

The investments in renewable energy with goals of net-zero by 2050 will necessitate a significant shift away from traditional power providers. The administration is enacting policies that encourage the development of other forms of distributed generation. The administration is investing in grid modernization efforts aimed at integrating more renewable energy and distributed generation into the system.

Overall, the Biden administration's energy policies represent a significant shift towards a more competitive and sustainable energy future. These changes have the potential to challenge the dominance of power provider monopolies and expose them to greater legal liabilities. However, it remains to be seen how these policies will be implemented and enforced, and what their long-term impact will be on the energy sector, especially if a different president sits in the Oval Office in 2025.

POTENTIAL LEGAL LIABILITIES

The sum of these policy changes will likely expose power provider to various legal liabilities that we see falling under three areas:

1) Antitrust lawsuits: power providers that engage in anti-competitive practices could be sued by the government or by competitors;
2) Consumer protection lawsuits: consumer harmed by unfair or deceptive practices by power providers could file lawsuits seeking compensation
3) Environmental lawsuits: power providers that violate environmental regulations could be fined and held liable for damages.

PUBLIC FINANCE IMPLICATIONS

While HELCO does not issue municipal bonds, there are conduit issuers that do and the utility provider has just under $500 million muni bonds outstanding, that have been cut to junk status as a result of the lawsuit and the wildfires in Maui earlier this year. In fact, electric

utilities issue a fare amount of municipal bonds, ranging anywhere from $7 billion to $18 billion USD annually in the last decade (**see figure, page 5**). While most service areas are covered by investor-owned power providers that rely more so on private financings, they do issue muni debt from time to time and public power utilities are significant issuers of municipal bonds to capture the relatively low tax-exempt borrowing rate. Still, in one way or another, much of the electric power complex has some connection to the municipal bond markets.

In the public power space, the Los Angeles Department of Water and Power (LADWP), Sacramento Municipal Utility District (SMUD) and Austin Energy are all service providers that issue municipal bonds that also have pending litigation similar to HELCO. The table, below, summarizes the legal issues and uses the numbers in "POTENTIAL LEGAL LIABILITIES" to organize them:

LADWP	1	Several class action lawsuits over unfair, discriminatory billing
	2	CPUC investing response to power outages
SMUD	3	Environmental groups suing over realiance on natural gas
	3	CPUC investing energy efficiency programs
	2	CPUC inveting whether programs distribute fairly
Austin Energy	1	TPUC investigating procurement practices

In the investor-owned space, the distribution is much larger. Large players such as Dominion Energy, Duke Energy, NextEra Energy, Southern Company and FirstEnergy Corp. together encompass a significant land area in the United States. Each named company faces some sort of litigation that range between all three areas identified above. Some utilize conduit issuers and tap into the municipal market for a variety of projects that serve a public purpose.

Litigation and the electric industry is by no means unusual but the larger policy shifts appear to be threatening these entities and a dynamic shift is likely to occur in the next decade. The likelihood of a shift away from the current structure to a decentralized one is unlikely but we are likely to see a different set of power brokers in the future. There will be some pain in that transition.

The risk to communities as litigation appears likely to rise is probably a short-tern increase in energy prices. The arguments for monopolies are efficiency, the ability to invest in long-term plans and their ability to manage the grid more effectively rather than a system of smaller players.