

BEFORE THE STATE CORPORATION COMMISSION
OF THE STATE OF KANSAS

In the Matter of the Application of Westar)
Energy, Inc. and Kansas Gas and Electric) Docket No. 18-WSEE-163-TAR
Company for Approval of Revisions to their)
Policy for Residential Subdivisions.)

NOTICE OF FILING OF STAFF'S REPORT AND RECOMMENDATION

The Staff of the Kansas Corporation Commission (Staff and Commission, respectively), pursuant to the Commission's *Order Granting Reconsideration*, hereby files its Report and Recommendation regarding the proposed scope of a general investigation into the acceptance of letters of credit in lieu of cash deposits from developers of residential subdivisions. Staff will also provide a courtesy copy of this Notice to affected utilities in the state.

Respectfully Submitted,



Michael Neeley, S. Ct. #25027
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STATE OF KANSAS)
) ss.
COUNTY OF SHAWNEE)

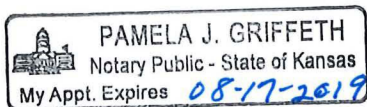
VERIFICATION

Michael Neeley, being duly sworn upon his oath deposes and states that he is Litigation Counsel for the State Corporation Commission of the State of Kansas, that he has read and is familiar with the foregoing *Notice of Filing of Staff's Report and Recommendation* and that the statements contained therein are true and correct to the best of his knowledge, information and belief.



Michael Neeley # 25027
Kansas Corporation Commission of the
State of Kansas

Subscribed and sworn to before me this 24th day of October, 2018.


Notary Public

My Appointment Expires: August 17, 2019

STATE OF KANSAS



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SHARI FEIST ALBRECHT, CHAIR | JAY SCOTT EMLER, COMMISSIONER | DWIGHT D. KEEN, COMMISSIONER

REPORT AND RECOMMENDATION UTILITIES DIVISION

TO: Chair Shari Feist Albrecht
Commissioner Jay Scott Emler
Commissioner Dwight D. Keen

FROM: Bill Baldry, Audit Senior
Justin Grady, Chief of Accounting and Financial Analysis
Jeff McClanahan, Director

DATE: October 23, 2018

SUBJECT: Docket No. 18-WSEE-163-TAR: In the Matter of a General Investigation to Evaluate Giving Electric and Gas Utilities the Authority to Accept an Irrevocable Letter of Credit as a Substitute for a Cash Deposit for System Expansion Related to Residential Development.

EXECUTIVE SUMMARY:

Westar Energy, Inc.'s (Westar or Company) Policy for Residential Subdivisions (Policy) is intended, in part, to limit Westar's investment in utility plant prior to eventual residential consumer demand for electricity. Under the current Policy, Westar requires a cash deposit (potentially refundable) from developers of residential subdivisions to cover infrastructure installation costs exceeding \$40,000 (Westar's allowance). In this Docket, Westar requested the Kansas Corporation Commission (Commission) approve proposed changes to the Policy, which would allow Westar to accept irrevocable letters of credit (ILOC)¹ in lieu of deposits from developers to cover installation costs in excess of the allowance. If, after five years, permanent meters have not been set on a sufficient number of lots to recover Westar's investment, Westar may draw on the ILOC for an amount equal to the unrecovered amount of its investment.

Commission Staff (Staff) had concerns that if Westar's Application was granted and irrevocable letters of credit are accepted, the carrying costs of the funds from utility operations would be included in rate base, with shareholders and ratepayers subsidizing developers. Staff discovered

¹ An ILOC is an official correspondence from a bank that guarantees payment for goods or services being purchased by an individual or entity (the Applicant) who requests the ILOC from the issuing bank.

some jurisdictional utilities already accept ILOCs in lieu of deposits from developers of residential subdivisions without specific tariff language detailing such practice. Staff recommended the Commission not approve Westar's proposal in this Docket and the Commission agreed. Staff recommended the Commission open a general investigation and the Commission agreed. The Commission directed Staff to file a Report and Recommendation to clarify the issues and define the scope of a general investigation by October 24, 2018.

BACKGROUND:

Westar's Policy for Residential Subdivisions (Policy) provides an allowance for the first \$40,000 in electric infrastructure costs for each residential subdivision project. The developer pays Westar a cash deposit that is equal to the estimated cost for the project less the \$40,000 allowance. As the developer builds homes and meters are set, the deposit is refunded on a per meter basis. Under the Policy, the developer has five years to finish a development before forfeiting the deposit.

Westar's Application

On October 16, 2017, Westar filed an Application requesting the Commission approve a revised version of its Policy for Residential Subdivisions. According to Westar, developers have approached Westar indicating the cash deposit requirement is burdensome and inhibits their development opportunities. Westar believes an ILOC will modernize Westar's business practices and assist with economic development. Therefore, Westar requested that developers be allowed to either pay Westar a deposit or provide an ILOC equal to the estimated cost for the project less the allowance.

Westar's Proposed Policy

Westar proposed to allow developers the option of substituting an ILOC for the currently required cash deposit for electric infrastructure in new residential subdivisions. The purpose of the deposit or the ILOC is to ensure that Westar is able to recover its costs of infrastructure investment if construction for a particular subdivision is stopped before completion.

Westar's Current Policy

Under the current policy, Westar provides a \$40,000 allowance toward a conventional overhead distribution system per subdivision or portion to be built in a 12-month period.² The developer is required to provide Westar a cash deposit equal to the difference between the \$40,000 allowance and the cost of the conventional overhead distribution system.^{3,4} Payment of the deposit must be

² Westar Tariff, Policy for Residential Subdivisions, Sheet 2, item 4.

³ Policy, Sheet 2, item 4.

⁴ If the developer chooses to install something other than a conventional overhead distribution system, the developer is responsible for the difference between the cost of the conventional system and the cost of the system selected by the developer (Policy, Sheet 3, item 6).

completed by the developer prior to the start of work.⁵ The developer is eligible for a refund on a per lot basis after construction and setting of permanent meters on at least the number of lots sufficient to cover Westar's investment.⁶ The developer will forfeit the remaining amount of its deposit if it does not complete the subdivision within a five-year period.⁷

Staff's Report and Recommendation

On May 2, 2018, Staff filed its Report and Recommendation, opposing approval of Westar's Application. Staff explained the cash deposit is supposed to allow Westar to recover its costs in the event construction on the subdivision is never completed. The cash deposits are treated for regulatory accounting purposes as Customer Advances for Construction (CAFC), which means the developer funds the extension of Westar's infrastructure necessary to connect the new subdivision. For ratemaking purposes, the customer advances are removed from rate base which recognizes the utility has not actually incurred the capital costs associated with the plant investment related to the subdivision. If Westar accepted ILOCs, the developer would not provide any up-front cash to fund the investment in infrastructure. To fund the development, the funds would come from utility operations. If Westar's proposal was accepted, shareholders would finance the cost of extending the infrastructure until there is a rate case, and then ratepayers would finance the carrying costs of the capital used to fund infrastructure going forward. Staff's investigation also revealed there is not a universal policy regarding whether utilities accept ILOCs in lieu of cash deposits.⁸ Because of a need for Commission policy regarding the acceptance of ILOCs in lieu of deposits and concern that Westar and ratepayers would finance the carrying costs of the capital used to fund the development of the subdivision, Staff recommended denial of Westar's proposal and recommended a general investigation be opened.

Westar's Response to Staff's Report and Recommendation

On May 14, 2018, Westar responded to Staff's Report and Recommendation arguing a general investigation would result in an unnecessary delay.⁹

Staff's Response

On May 22, 2018, Staff responded to Westar's response and reiterated its support of a general investigation.

⁵ Policy, Sheet 3, item 7.

⁶ Policy, Sheet 3, item 4(d).

⁷ Policy, Sheet 3, item 4(d).

⁸ Staff Report and Recommendation, page 2.

⁹ Response to Staff Report and Recommendation, May 14, 2018, ¶4.

Wichita Area Builders Association, Inc.

On June 12, 2018, the Commission granted the Wichita Area Builders Association, Inc. (WABA) intervention.¹⁰

Order Denying Application

On June 12, 2018, the Commission issued an Order Denying Application. The Commission denied Westar's Application because of its concern that if irrevocable letters of credit were accepted, the carrying costs of financing the extension of the infrastructure would be included in rate base, with shareholders and ratepayers subsidizing developers.¹¹

Wichita Area Builders Association, Inc. Petition for Reconsideration and Clarification

On June 27, 2018, WABA filed a Petition for Reconsideration and Clarification asking the Commission to open a general investigation to address the issue of accepting irrevocable letters of credit in lieu of cash deposits from developers of residential subdivisions.

Staff's Response to WABA's Petition for Reconsideration and Clarification

On July 5, 2018, Staff filed its Response to WABA's Petition for Reconsideration and Clarification supporting the opening of a general investigation. As part of the general investigation, Staff suggested the Commission consider general risks of non-cash security, accounting treatment that could prevent subsidization, and whether uniformity throughout the industry is preferable.¹²

Order Granting Reconsideration

On July 17, 2018, the Commission directed Staff to file a Report and Recommendation to clarify the issues and define the scope of a general investigation by October 24, 2018.

ANALYSIS:

The Commission issued an Order on July 17, 2018, granting reconsideration and directed Staff to file a Report and Recommendation by October 24, 2018 that would clarify the issues and define the scope of a general investigation. The following list defines the scope and issues that Staff believes need to be covered in a general investigation:

1. Should a natural gas or electric utility be allowed to accept an irrevocable letter of credit (in lieu of a cash deposit) when extending its distribution infrastructure at the request of a developer of a new residential or commercial development?

¹⁰ Petition for Intervention of Wichita Area Builders Association, Inc., May 29, 2018, ¶2.

¹¹ Staff Report and Recommendation, page 4.

¹² Staff's Response to WABA's Petition for Reconsideration and Clarification, ¶3.

2. What are the risks to the utility and to ratepayers if a developer issues an irrevocable letter of credit (ILOC) to the utility? By accepting an ILOC, is the risk of funding the distribution system expansion transferred from the developer to utility shareholders and ratepayers? Is this risk the same during construction versus after construction?
3. Are there times when it would be inappropriate for a utility to accept an ILOC in lieu of a cash deposit?
4. Are there other alternatives besides cash and ILOCs that guarantee payment if a developer fails to complete the development?
5. Should there be a specified number of years that an ILOC should cover for a developer to complete a development before the utility could draw on the ILOC? If yes, how many years would be appropriate?
6. Should there be standardized criteria a utility would need to use to determine when it could draw on the ILOC? i.e., number of years to completion.
7. What are the procedures if the financial institution has indicated its intent not to renew an ILOC, prior to the expiration of the currently outstanding letter of credit?
8.
 - a. What are the procedures if the financial institution that issued the letter of credit fails to honor the utility's request to draw on an outstanding letter of credit?
 - b. Should shareholders or ratepayers be responsible for the financial consequences of this occurrence?
9. Should a utility be required to accept confirmed and unconfirmed letters of credit as a risk mitigation strategy? Please explain why or why not. Under a confirmed letter of credit, the irrevocable payment undertaking comes from not only from the issuing bank, but also from the confirming bank as well. The issuing bank and the confirming bank give separate irrevocable payment undertakings. Under an unconfirmed letter of credit, the issuing bank is the main institution that gives the irrevocable payment undertaking.
10. Should utilities only be allowed to accept confirmed letters of credit? What conditions or situations would make it inappropriate for a utility to accept an ILOC?
11. How do utilities currently account for a distribution system expansion under construction (residential subdivision or commercial development) that is being funded by a developer's cash deposit?
12. Would the accounting differ for a distribution system expansion under construction where a developer issued an ILOC?
13. When does a utility transfer a construction project from construction work in progress (CWIP) to plant in service (PIS)? Is a construction project transferred from CWIP to PIS when the customers in the development become active? Or when construction is complete? In other words, does the accounting and tracking of CWIP versus PIS follow the refunding of Customer Advances for Construction?

14. Are there any accounting practices that utilities should be required to use that would prevent ratepayers from being exposed to the risk of funding system expansions in the short and long-term?
15. If ILOCs are an acceptable form of deposit (in lieu of cash), what are the restrictions, if any, the Commission should place on the types or specific provisions of the ILOC?
16. If the cost of installing the distribution lines is greater than originally estimated, should there be provisions that enable the ILOC to be amended?
17. If ILOCs are an acceptable form of deposit (in lieu of cash), what specific requirements should be established for a financial institution to be eligible to issue an ILOC to a developer? Should only banks be allowed to issue ILOCs or should other financial institutions be allowed to issue ILOCs?
18. Should there be a maximum letter of credit exposure for the utility? If yes, should the credit exposure be measured as a stated dollar amount or be based on a percentage of the utility's gross assets, net assets, utility's stockholders' equity, etc?
19. Are there any other states that accept irrevocable letters of credit in lieu of cash deposits?
20. If the current policy of cash only remained in effect, what effect would that policy have on developers choosing other states to do their development projects?
21. What effect would a cash or ILOC policy have on developers' in developing future subdivisions? Would the policy increase development activity or would development remain about the same?

RECOMMENDATION:

Staff recommends the Commission issue an Order opening a general investigation to investigate whether developers should be able to use irrevocable letters of credit as an option compared to the use of deposits only in the installation of conventional distribution systems in the development of residential subdivisions and if it is in the public interest. Staff further requests the Commission direct Kansas electric and gas utilities to respond to the questions proposed in this R&R within 90 days and provide any other information that the parties deem pertinent to the question of whether the use of irrevocable letters of credit as an option is in the public interest. After the utilities respond to these questions, Staff will file a pleading summarizing the comments and either recommend specific action of the Commission or noting whether follow up questions should be asked of the utilities.

CERTIFICATE OF SERVICE

18-WSEE-163-TAR

I, the undersigned, certify that a true and correct copy of the above and foregoing Notice of Filing of Staff's Report and Recommendation was served by electronic service on this 24th day of October, 2018, to the following:

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