Transition Costs in the Electricity Market  
Cost History and Cost Recovery

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- Recovery of sunk cost in a transition to a market is a matter of equity, not of right. Policymakers/regulators will react to assure recovery of such only costs to the extent they must to assure adequate and reliable service.

- They will also react where some notion of fairness says they should. The issue I have been trying to think through is the extent to which the history of particular transition costs – stranded investments, assets and obligations – may result in varying treatments. Those of these which exist because of regulatory commission direction or compulsion or involvement ought to be more favorably treated than those which, in some sense, were created by the choice of the utility.

- My main concern as I try to think about this is that I keep finding myself humming the tune from the play 1776 by the name of, "Is Anybody There, Does Anybody Care?"

- Three areas:
  - Plant investments: nuclear and fossil (and related fuel supply obligations)
  - Non-utility supply obligations
  - Regulatory assets

- Notion is to look at each of these insights as to who might appropriately bear the cost determining:
  - Its magnitude;
  - The time when it hits;
  - What caused it to come into being; and
  - What third parties are involved.

As one does this, it seems to me that every utility will be different in terms of the size of the problem, the timing of the problem and the source of the problem.

- I anticipate a system characterized by:
Electric generation becoming increasingly deregulated with ever larger numbers of customers having the right to shop, and

- A form of incentive-based "caps" regulation for captive customers

Assuming this to be the case, uneconomic costs might be allocated, in part or in whole,

- To all customers in the service territory through an "up lift" charge.
- To all customers in the service territory through a wires or access charge.
- To captive customers to the extent the cap allows.
- To investors.

**Plant Investments**

- Includes nuclear and fossil plants and related fuel obligations.

  Many plants have been the subject of prior decisions intended to allocate responsibility for uneconomic generating facilities as between investors and (the then set of) customers. While this was mainly related to nuclear plants at the time of construction completion, some large fossil plants were also subject to such treatment.

  Some of these were disallowances resulting in write-offs at that time. Some were deferrals either by "phase-in" plans or depreciation devices. Should some or all of these prior allocations of uneconomic cost be preserved?

  These plants have particular sets of environmental, fuel source and local economic (tax and employment) characteristics. Allocation of the responsibility for the costs associated with these plants will not only move dollars around but will clearly impact whether the facilities will survive and operate.

- Many companies have long-term fuel supply relationships with either captive, owned or independent suppliers. These may be above current market for the fuel itself or the combination of the fuel and plant costs may result in plant closing or curtailment. Some of these relationships have been the
subject of prior regulatory decisions allocating responsibility for uneconomic fuel supply. In the case of independent fuel suppliers, there is another set of owners/investors who might fund themselves at risk from deregulation.

- Uneconomic costs associated with plant investments will tend towards being incurred now and will tend to decline with time (assuming rising electricity prices).

**Non-Utility Supply**

- There is probably a greater degree of variation across the industry in the relationships with NUGs than with owned generation.

- Some contracts are a result of federal and/or state policies which encouraged or compelled acquisition of supply -- needed or not -- from NUGs. PURPA; NY 66 law; various standard offers. Some were affirmatively sought by utilities to avoid constructing additional facilities.

- Some contracts are uneconomic because of practices of utilities in the 1980’s of persistently overstating avoided cost. Some are because utility commissions established high (e.g., "coal proxy") avoided costs.

- Some contracts have "regulatory out" clauses. Some do not. Some state commissions forbid "regulatory out" clauses as being unnecessary.

- Some facilities have local impacts which are deemed to be desirable (tax, waste disposal, employment).

- Pricing may have been front end loaded to allow facilities to be financed.

- Many facilities are not yet financed or built. Opportunities exist to reduce future (unregulated) exposure while still receiving cost recovery.

- There are owners and lenders in NUGs who might share the burden of deregulation.

- The time impact of NUG diseconomies is likely to be later than that associated with owned plants.
Regulatory Assets

- There is great variety in source and magnitude. As a first distinction, some would be associated with generation and some with the wires business. The greatest amounts are probably with the former.

- Some were created to reduce rates at the time new plants — mainly nuclear — were being constructed and placed in service.
  - Flow-through of tax benefits
  - Phase-in plans
  - Artificially slow depreciation

Some result from plant abandonment either prior to or at the end of service life. As to both of these, there was probably an earlier political action to share and allocate the uneconomic amount.

- I think of nuclear decommissioning as a regulatory asset. Recovery is needed both for current portion and catch up of underfunding.

- Pension and other post-retirement benefit underfunding.

- DSM.

- Some result from changes in local laws (tax, environmental).