ORIGINAL

UNITED STATES OF AMERICA

NUCLEAR REGULATORY COMMISSION

Title: BRIEFING ON ELECTRIC UTILITY RESTRUCTURING - PUBLIC MEETING

Location: Rockville, Maryland

Date: Thursday, April 24, 1997

Pages: 1 - 143

ANN RILEY & ASSOCIATES, LTD.
1250 I St., N.W., Suite 300
Washington, D.C. 20005
(202) 842-0034

DISCLAIMER

This is an unofficial transcript of a meeting of the United States Nuclear Regulatory Commission held on April 24, 1997 in the Commission's office at One White Flint North, Rockville, Maryland. The meeting was open to public attendance and observation. This transcript has not been reviewed, corrected or edited, and it may contain inaccuracies.

The transcript is intended solely for general informational purposes. As provided by 10 CFR 9.103, it is not part of the formal or informal record of decision of the matters discussed. Expressions of opinion in this transcript do not necessarily reflect final determination or beliefs. No pleading or other paper may be filed with the Commission in any proceeding as the result of, or addressed to, any statement or argument contained herein, except as the Commission may authorize.

1 UNITED STATES OF AMERICA

2 NUCLEAR REGULATORY COMMISSION

3 - - -

4 BRIEFING ON ELECTRIC UTILITY RESTRUCTURING

5 - - -

6 PUBLIC MEETING

7

8 Room 1F16

9 11555 Rockville Pike

10 Rockville, Maryland

11

12 Thursday, April 24, 1997

13

14 The Commission met, pursuant to notice, at 9:00

15 a.m., Shirley A. Jackson, Chairman, presiding.

16

17 BEFORE:

18

19 SHIRLEY A. JACKSON, Chairman

20 GRETA J. DICUS, Commissioner

21 KENNETH C. ROGERS, Commissioner

22 NILS J. DIAZ, Commissioner

23 EDWARD McGAFFIGAN, JR., Commissioner

24

25

1 STAFF AND PRESENTERS SEATED AT THE COMMISSION TABLE:
2 JOHN C. HOYLE, Secretary
3 KARYN D. CYR, General Counsel
4 LEONARD JOSEPH CALLAN, EDO
5 DAVID MATTHEWS, Chief, Generic Issues and
6 Environmental Projects Branch, NRR
7 ROBERT WOOD, Senior Financial Analyst, NRR
8 MARYLEE SLOSSON, Deputy Director, Division of
9 Reactor Program Management, NRR
10 SUSAN TOMASKY, General Counsel, FERC
11 BRUCE B. ELLSWORTH, Commissioner, New Hampshire
12 Public Utilities Commission, President, NARUC
13 ROBERT W. GEE, Commissioner, Texas Public
14 Utilities Commission, Chair, NARUC Commission on
15 Electricity
16 EMMIT GEORGE, JR., Commissioner, Iowa Utilities
17 Board, Chair, NARUC, Subcommittee on Nuclear
18 Issues, Waste Disposal
19 E. LINN DRAPER, JR., Chairman, President and Chief
20 Executive Officer, American Electric Power
21 Service Corporation
22 JOE COLVIN, President and Chief Executive Officer,
23 NEI
24 PHIL HARRIS, President, PJM Interconnection
25 Association

1 STAFF AND PRESENTERS SEATED AT THE COMMISSION TABLE:
2 [continued]
3 JAMES ASSELSTINE, Managing Director, Lehman
4 Brothers
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25

1 P R O C E E D I N G S

2 [9:00 a.m.]

3 CHAIRMAN JACKSON: Good morning, ladies and
4 gentlemen.

5 The historic change to a competitive market for
6 the electric power industry is having far-reaching
7 consequences and presents many challenges for the nuclear
8 power industry. As restructuring proceeds and the business
9 environment changes, our licensees and the NRC must ensure
10 that economic pressures do not erode nuclear safety and must
11 assure the adequacy of decommissioning funding.

12 To ensure that the NRC is taking the right actions
13 at the right time in the appropriate manner, it is important
14 that we gain an understanding of the changes and emerging
15 issues that are occurring as a result of these momentous
16 changes. To address the significant issues and concerns,
17 the NRC has brought together economic regulators and
18 representatives of the nuclear industry as well as our own
19 staff to present their roles and perspectives on the future
20 of the electric power industry with the transition to a
21 competitive market.

22 Yesterday, we focused in a Commission meeting,
23 public meeting, on transmission reliability and security.
24 Today, we will focus on other issues associated with
25 electric utility restructuring and economic deregulation.

1 The restructuring of existing utilities raises a number of
2 complex issues. We are seeing proposed legislation at the
3 federal and state levels and many new financial
4 arrangements.
5 The NRC needs to keep itself abreast of
6 developments and be able to respond to legislative proposals
7 and financial changes which include mergers and
8 acquisitions, antitrust issues, stranded cost recovery and
9 the introduction of independent system operators.
10 I would like to welcome the NRC staff and the
11 members of the two panels that will be speaking today on
12 these issues.
13 On the first panel, after the staff speaks, will
14 be Susan Tomasky, General Counsel for the Federal Energy
15 Regulatory Commission; Commissioner Robert Gee, Chair of the
16 NARUC Committee on Electricity; Commissioner Bruce
17 Ellsworth, President of NARUC; and, commissioner Emmit
18 George, Chair of the NARUC Subcommittee on Nuclear Issues
19 and Waste Disposal.
20 I am also pleased and will welcome them again at
21 the time, to welcome the members of the second panel,
22 Mr. Joe Colvin, President and CEO of the Nuclear Energy
23 Institute; Dr. E. Linn Draper, Chairman, President and Chief
24 Executive Officer of Electric Power Service Corporation;
25 Mr. Phil Harris, President of PJM Interconnection

1 Association; and Mr. James Asselstine, former Commissioner,
2 now Managing Director of Lehman Brothers.
3 If the Commissioners have no opening comments,
4 Mr. Callan, please proceed.
5 MR. CALLAN: Good morning, Chairman and
6 Commissioners.
7 Chairman, as you just noted, we are the first of
8 several panels to brief the Commission on the status of
9 economic deregulation and restructuring of the electric
10 utility industry. As you know, the NRC staff has, at the
11 Commission's direction, undertaken several initiatives to
12 address the NRC's concerns about the potential health and
13 safety impacts of economic deregulation of its power reactor
14 licensees. Our briefing will update you on the status of
15 our initiatives and will highlight several issues currently
16 of concern to the NRC and other participants in the
17 deregulation process.
18 This is our first briefing to the full Commission
19 since July 30, 1996.
20 With me this morning are Marylee Slosson, the
21 Deputy Director of the Division of Reactor Program
22 Management in the office of NRR, David Matthews, a branch
23 chief, who works for Marylee Slosson, and Robert Wood.
24 I will now turn the briefing over to David
25 Matthews.

1 David.

2 MR. MATTHEWS: Thank you, Joe, and good morning.

3 I am only going to spend a couple of minutes by

4 way of brief summary and an outline of the staff's intended

5 remarks.

6 If I could have the first slide, please?

7 As Mr. Callan indicated, we briefed the full

8 Commission in July of last year with regard to a seven point

9 action plan that the staff had undertaken starting in

10 February of 1996. Today, we did not intend to go by rote

11 through the individual items of that action plan because we

12 view that that progress is generally well known. We have

13 briefed the status of that action plan in many fora over the

14 last few months. We did, however, want to focus on what we

15 view to be the accomplishments that have been afforded

16 through those efforts within the last year or 18 months.

17 I want to comment at this time, as an outgrowth of

18 our last briefing in July, the Commission raised an issue to

19 the staff for us to consider in connection with this general

20 area of restructuring and that was the issue of non-owning

21 operators who -- proposals had been offered associated with

22 the operation of plants by people who had not previously

23 been listed on the license and weren't licensees.

24 The staff has, at the Commission direction,

25 undertaken a separate review of that issue and a paper

1 presenting some policy considerations is in preparation and
2 is due to the Commission here in the next month or two.
3 CHAIRMAN JACKSON: You will not be speaking
4 specifically to that today?
5 MR. MATTHEWS: Right, although we will indicate
6 that that is one of the "emerging issues," because of the
7 unique arrangements that are materializing. It is not one
8 that we are prepared to speak to in detail at this time.
9 With that, I want to indicate that Bob Wood will
10 carry us through the presentation and he will focus on the
11 accomplishments of the last 12 or 18 months. He will also
12 briefly review what is the continuing NRC's involvement and
13 review in restructuring activities that are taking place in
14 the recent past, as we speak today and in the near future.
15 He will also mention what we see to be some emerging issues
16 that the NRC certainly has to keep an eye on and then
17 particularize it to a few issues that we think the NRC has
18 to be actively involved in addressing in the hear future and
19 then he will provide a summary and conclusions.
20 MR. WOOD: Thanks, Dave.
21 Slide number 2.
22 Chairman Jackson, Commissioners, I am happy to be
23 here.
24 CHAIRMAN JACKSON: We are happy to have you.
25 MR. WOOD: We issued the action plan, as Dave

1 mentioned, back last February with seven elements. Most of
2 those elements are on here. I will try to be very brief in
3 summarizing them. As you all remember, we issued an
4 advanced notice of proposed rulemaking in April on
5 decommissioning funding assurance and that now is coming
6 close to final internal completion and will be coming up to
7 the Commission as a proposed rule.
8 CHAIRMAN JACKSON: When do you anticipate that?
9 MR. WOOD: It will probably go to the EDO's office
10 within a day or two.
11 CHAIRMAN JACKSON: So, in May?
12 MR. WOOD: Sometime in May.
13 CHAIRMAN JACKSON: Okay.
14 MR. WOOD: The administrative letters that we
15 issued to all of our power reactor licensees last June
16 reminded them of their obligation to inform us of any
17 activities that might be considered direct or indirect
18 transfer of control of the license under our 50.80 reviews
19 and we have gotten a few responses back on that from time to
20 time since then.
21 We issued a draft policy statement on September
22 23. We extended the comment period once because of interest
23 expressed by the public. The final policy statement is now
24 under staff review and is moving along internally and will
25 be up to the Commission sometime later in June, I believe.

1 The draft standard review plans that were issued
2 in concert or prepared in concert with a draft policy
3 statement were published or notice of availability was
4 published in the Federal Register on December 27. As you
5 may remember, the standard review plans concern both the
6 financial qualifications, review process and the
7 decommissioning funding assurance review process as it
8 stands now and there is a separate standard review plan on
9 the antitrust review process. We got six comments back on
10 that and will be revising the standard review plans based on
11 those comments.
12 We have ongoing staff level liaison function that
13 I think is going along very well with FERC and with the
14 state PUCs through the NARUC committee framework. And,
15 finally, we have work going on with the Financial Accounting
16 Standards Board endorsing right at this point what they call
17 an exposure draft which is a draft proposal which would give
18 us information on the status of decommissioning funds.
19 Finally, we have an ongoing evaluation of our
20 50.80 process and our general financial qualifications
21 framework and I will get into that a little bit more.
22 CHAIRMAN JACKSON: When do you expect your review
23 of the FASB exposure draft?
24 MR. WOOD: Well, we have a guide which has been
25 prepared which endorses the exposure draft. We are at the

1 mercy, of course, of FASB's schedule. My understanding is
2 that FASB will probably either be issuing another exposure
3 draft because of issues raised for non-nuclear facilities
4 that also have long lives and have costs associated with
5 their ultimate disposal. So they may do that in the second
6 quarter of this year, which we are in now, of course. I
7 understand that at the earliest, the final FASB guide or
8 regulation wouldn't be coming out until December of this
9 year.
10 CHAIRMAN JACKSON: This relates to reporting
11 requirements?
12 MR. WOOD: This relates to reporting requirements
13 and the status of decommissioning and how people or
14 companies would deal with the ultimate liability to get rid
15 of that obligation.
16 Slide 3, please.
17 We believe that we have fairly well summarized the
18 current process that we use by issuing the standard review
19 plans. We will, of course, be changing the standard review
20 plans as we change the regulations that underlie them. As I
21 mentioned earlier, we have been reviewing all restructuring
22 proposals under our 50.80 transfer of license requirements.
23 So far, we haven't seen any divestitures of assets. Most of
24 the things we have seen so far have been mergers or
25 formations of holding companies.

1 We do expect to see future issues where
2 divestiture is raised. We also expect to see future issues
3 where proposed purchases by foreign entities may occur.
4 Basically, our review is basically
5 straightforward. As you know, we have a dichotomy in our
6 regulations for power reactor licensees between those that
7 are defined as electric utilities in our regulations in the
8 definition section and then nonelectric utilities. And
9 electric utilities have, because of their historic access to
10 ratepayers through regulated rates, have a little bit lower
11 threshold to meet than nonelectric utilities. We do
12 ascertain in our reviews that a licensee would remain an
13 electric utility and if they don't they would have to comply
14 with the more rigorous standards that pertain to the
15 electric utilities.
16 For holding companies, what we are concerned about
17 is as holding companies are formed over our existing
18 licensees that there may be transfers of assets away from
19 our licensees to a parent or affiliated company. So we have
20 been getting commitments from licensees that they will
21 inform us if there are any significant transfers of assets
22 so that we will at least know about it and take appropriate
23 action if we need to.
24 CHAIRMAN JACKSON: Let me ask you two questions.
25 One, in terms of obtaining the commitments to inform the NRC

1 when significant assets are moved, are those commitments
2 made a part of the license or the license transfer?
3 MR. WOOD: We do have, in recent -- in the last
4 year or so made them as license conditions. Prior to that,
5 there was less consistency on that approach and we had
6 obtained letters. One thing in this broader review of our
7 financial qualifications framework, I think we are certainly
8 looking at the feasibility of whether to make that a
9 requirement in the regulations rather than doing it through
10 the license condition process.
11 CHAIRMAN JACKSON: If you were to do that, would
12 that require a separate rulemaking or you would be doing
13 this in the rulemaking coming forward in May?
14 MR. WOOD: It won't be part of the rulemaking
15 coming forward in May. It would be a separate rulemaking.
16 This rulemaking would look at more of the general
17 qualifications process. The rulemaking that is coming
18 forward in May is looking specifically at decommissioning
19 funding assurance and the impacts of deregulation on that.
20 CHAIRMAN JACKSON: As a general practice today,
21 you are making these commitments license conditions going
22 forward?
23 MR. WOOD: Right.
24 CHAIRMAN JACKSON: And the second question has to
25 do with consideration of foreign ownership issues. How well

1 prepared are we in terms of reviewing those?

2 MR. WOOD: I think we have to do some more work on

3 what the standards are. I think at this point part of the

4 problem is, you know, clearly any entity that owns over 50

5 percent of a licensee and is foreign would raise -- would

6 probably be in contravention of the Atomic Energy Act. Just

7 as clearly, if there is a de minimis amount, under say 5

8 percent, it would be highly unlikely where they could

9 exercise any form of control.

10 But you have a gray area in between that you would

11 have to evaluate. In most cases, foreign companies aren't

12 going to exercise control with 10 or 20 percent of voting

13 stock but not always. So we would have to look at each

14 particular situation, I think.

15 CHAIRMAN JACKSON: I guess I am really asking two

16 questions. One is, how well prepared are we in terms of

17 being able to look at what may be less than obvious

18 situations? That's number one.

19 Number two, how well prepared are we to move

20 quickly relative to those reviews?

21 MR. WOOD: You know, I think we could make a

22 review and I don't think it would be on the critical path;

23 it would be on the general review that we would look at and

24 it would take, like most reviews do now, in the order of

25 three to six months and it would be another element we would

1 look at.

2 At the same time, I think we want to look at

3 resolving, if we can, some sort of benchmarks or milestones

4 below which we wouldn't have to look at at all or above

5 which we would clearly have to look at.

6 CHAIRMAN JACKSON: How close are you to developing

7 such thresholds?

8 MR. WOOD: We are starting on that but we haven't

9 gone very far into it.

10 MR. MATTHEWS: Let me make a comment that it is an

11 element that is required of us and we have looked and

12 addressed it in each SER that we have issued associated with

13 the proposed restructuring or change in ownership. So it is

14 an essential element because it is a prohibition in the

15 Atomic Energy Act. We just have not seen one that would

16 challenge our judgment in that regard. Namely, there just

17 hasn't been a case in which we have uncovered any foreign

18 ownership.

19 So it is an explicit part of our review and we

20 have been addressing it in each instance. Where the

21 challenge will come is the first time that we see one with

22 some material ownership and then we are going to have to

23 evaluate its significance. To say that we have criteria

24 would be a strong overstatement; we don't.

25 I believe it is something that could be factored

1 in, appreciating that it might take some additional time,
2 into our standard review plan. That may be an appropriate
3 mechanism to do it. But it is one of those many emerging
4 issues that the staff has yet to articulate any clear
5 standards on.
6 MR. WOOD: Yes, we do have a statement in the
7 current standard review plan that went out on foreign
8 ownership but it is very broad and very general and that was
9 the best we could do, given the time constraints at that
10 time. We are going to have to revisit that.
11 CHAIRMAN JACKSON: Commissioner McGaffigan.
12 COMMISSIONER McGAFFIGAN: On the definition of
13 electric utility, as states go about passing retail
14 competition statutes, will that move utilities from being an
15 electric utility under our definition into the other
16 category at some point in time?
17 MR. WOOD: It all depends on the specific state
18 proposal.
19 COMMISSIONER McGAFFIGAN: So you are going to have
20 to audit each state proposal?
21 MR. WOOD: Well, yes. And in the proposed rule
22 that will be coming up we do try to address the issue of
23 those states that do have dedicated nonbypassable charges
24 that take care of decommissioning funding. We would want to
25 handle that in our regulations so that I think the staff's

1 thinking is for that purpose they would still be considered
2 an electric utility even though for other purposes they may
3 not be. So you could have a divergence.
4 COMMISSIONER McGAFFIGAN: Depending on how
5 decommissioning funds are handled in the state statute?
6 MR. WOOD: Right.
7 COMMISSIONER McGAFFIGAN: Have we conveyed that
8 tentative position to the states?
9 CHAIRMAN JACKSON: We just did, if we did not
10 before.
11 [Laughter.]
12 COMMISSIONER McGAFFIGAN: Fair enough.
13 MR. WOOD: You would have -- you could be
14 considered to be an electric utility from the point of view
15 of decommissioning funding assurance if states had
16 mechanisms for that. Whereas, the same entity might not be
17 for general financial qualifications to operate the plant.
18 Slide 4, please.
19 The emerging issues as we see that, I am not going
20 to mention any more about grid reliability and ISOs. You
21 had a very detailed meeting yesterday afternoon on that
22 subject.
23 We do see some issues with respect to unique
24 ownership and operating arrangements which gets back to
25 Dave's earlier remarks about non-owner operators and how

1 they might play out in some of our considerations.

2 CHAIRMAN JACKSON: What are some of the issues

3 that you are considering?

4 MR. WOOD: I think I will really -- if I may, I

5 will use the recent Maine Yankee Entergy agreement as kind

6 of a template for what we have done and we looked at that

7 proposal particularly. Because Maine Yankee had retained

8 responsibility and ultimate authority to shut the plant down

9 and control over ultimate spending, we didn't see any real

10 problems with that.

11 Other proposals may come along that may not have

12 all those elements in them and we may raise our level of

13 concern as a result. There again, I think we have to be

14 concerned about future partnership forms and we are just not

15 sure what those are. I think we would certainly be

16 concerned about -- that the licensee has to maintain control

17 in some way or that whoever takes the authority gets put on

18 the license.

19 There, as you know, there are two issues involved

20 in this, in this 50.80 transfer process. It is both

21 financial qualifications and technical qualifications. We

22 do have to look at those.

23 As Dave mentioned, we will be addressing this

24 whole issue in more detail in the paper that will be coming

25 up to the Commission in the near future.

1 CHAIRMAN JACKSON: You mentioned the issue with
2 respect to future partnership forms of whoever takes on the
3 authority. You mean the operational authority?
4 MR. WOOD: Right.
5 CHAIRMAN JACKSON: Gets put onto the license?
6 MR. WOOD: Right.
7 CHAIRMAN JACKSON: Was Entergy put onto the
8 license?
9 MR. WOOD: No, because of Maine Yankee's retaining
10 of the ultimate authority and control, we did not do that in
11 that case.
12 CHAIRMAN JACKSON: Okay.
13 Commissioner McGaffigan.
14 COMMISSIONER McGAFFIGAN: Are we going to suggest
15 templates for partnership forms that will pass muster? Are
16 we going to do this sort of case by case and let a body of
17 case law build up so that people will recognize what we
18 approve and what we don't approve?
19 MR. WOOD: I think we probably are going to end up
20 doing it case by case because I don't think we can visualize
21 at this point all the potential permutations of what might
22 come in.
23 We do have antitrust issues that we are going to
24 look at, of course, statutiorally required to do so. As I
25 did mention earlier also, we have seen a number of state

1 initiatives now where, in most cases, they have provided for
2 a secure source of revenue streams, at least for
3 decommissioning. There is also the broader issue of
4 resolution of stranded costs in general, including recovery
5 of capital costs, which I think we are probably less
6 concerned about unless it gets to the point where the lack
7 of that recovery stresses a utility -- a licensee enough
8 financially that they would have trouble running the plant
9 safely.
10 As I mention also, a lot of these approaches that
11 the states are using in terms of nonbypassable charges seem
12 to be a good surrogate for the existing approach to rate
13 regulation and rate recovery. If that process continues to
14 hold, I think we will be in pretty good shape. Of course,
15 we don't have a crystal ball and some states may not choose
16 to go that route.
17 CHAIRMAN JACKSON: So a key to avoiding our having
18 to take direct action with respect to our licensees is the
19 issue of nonbypassable charges?
20 MR. WOOD: I believe so, yes.
21 CHAIRMAN JACKSON: Okay.
22 MR. WOOD: Next viewgraph, please.
23 There are a number of issues that we have
24 already -- Dave has already covered and I have touched on
25 the issues that have to be addressed and possibly resolved.

1 As I mentioned earlier, there is this broad look that we are
2 initiating now in terms of the general 50.80 review process
3 and even our -- the financial qualifications review process
4 under 50.33(f) and we will be at some point coming up with
5 the policy options on that for the Commission's
6 consideration.
7 CHAIRMAN JACKSON: At some point, what does that
8 mean?
9 MR. WOOD: Sometime this summer, I believe.
10 CHAIRMAN JACKSON: Okay.
11 MR. WOOD: We have a concern, we have gotten
12 several comments both on the draft policy statement and the
13 standard review plans and the regulatory information
14 conference earlier this month on industry's concern about
15 having very specific defined NRC position on what we expect
16 in our financial qualifications review. We thought we did
17 that in the policy statement and in the standard review
18 plans. I think they want an even firmer line in the sand.
19 I am not sure how we can do that, given that we
20 don't really know what is going to happen in the future and
21 there are many variations on restructuring but we will be
22 considering that, of course.
23 We are, of course, concerned about the
24 acceptability of the level of decommissioning funding
25 assurance that might come out in some state restructuring

1 approaches and we will have to look at those as they
2 develop. We are concerned also about the availability of
3 funding assurance mechanisms to nonelectric utilities as
4 they get kicked out of this category into being a
5 nonelectric utility, they would no longer be allowed to put
6 money aside annually over the projected life of the reactor;
7 they would have to come up with some sort of guarantee
8 mechanisms for any unfunded balance. To do that, they would
9 either have to prepay or use a surety bond or a letter of
10 credit or a guarantee coupled with a financial test. It is
11 not clear in all cases where those would be available to
12 those licensees that need them.
13 Finally, we are looking at the possible need for
14 federal legislation in various areas of restructuring.
15 CHAIRMAN JACKSON: Which areas do you feel need
16 perusal with respect -- are you perusing with respect to the
17 need for federal regulation?
18 MR. MATTHEWS: Let me speak to the issue of
19 federal legislation. It is one that we have become
20 increasingly involved in, in concert with Karen's staff.
21 We met with the Department of Energy within the
22 last few weeks and received an explicit invitation to
23 participate with them in even to the point of drafting
24 legislative proposals in concert with their staff. We are
25 proceeding next week to sit down for our first meeting to

1 examine the alternatives.

2 So we have just at this point in time come up with
3 some areas to discuss with them jointly and I will just give
4 you the flavor for what those areas are. These aren't in
5 any order of preference; they are just areas that have been
6 raised by the staff and outside interest as being an area
7 where there may be a need for federal legislation to
8 backdrop or give a statement of congressional intent or
9 support as state-specific and FERC initiatives in the
10 restructuring area go forward.

11 I say it that way because I don't believe we have
12 identified, with the possible exception of one area any
13 areas that we think we need bolstering in terms of our
14 regulatory authority in this area as we move forward in the
15 sense that we have some large gap. I look to Karen to
16 correct me on that statement if that is not true. So it is
17 along the lines of providing support.

18 One area is bankruptcy priorities, as you may see
19 bankruptcies coming out of some of these restructurings,
20 particularly those in the Chapter 11 category. We certainly
21 would like to see some support for the view that
22 decommissioning funding would have a priority associated
23 with any such cases, even in advance of preferred creditors.
24 So that is one of the -- one of the areas for discussion.

25 Certainly, the treatment of decommissioning funds

1 in the overall context of stranded costs as we have
2 discussed here is important. Given the variability of some
3 of those proposals, some statement of federal intent in that
4 regard, possibly deferring to an agency such as ours and
5 FERC to address that issue, might be a possible proposal.
6 The antitrust area is one that we think it is
7 worth examining. There have been calls for us to remove
8 ourselves from the antitrust arena given the number of
9 people that do look at that area. One of the consequences
10 of an antitrust or the removal of antitrust review
11 responsibilities from the Atomic Energy Act as it applies to
12 the NRC's responsibilities is that we have a number of
13 licensees, those licensed since 1970, that have existing
14 antitrust license conditions and we would have to do an
15 assessment of what the impact of removing our statutory
16 authority in that area would be on those existing conditions
17 so the issue is not as simple as just eliminating the review
18 requirement. That is one that is at least ripe for
19 discussion.
20 CHAIRMAN JACKSON: Have we begun to take that
21 look?
22 MR. MATTHEWS: We have gone so far as within the
23 next few weeks you will see a NUREG document published that
24 will at least collate all of the existing antitrust license
25 conditions in one location in order to at least have a

1 baseline of reference to begin that assessment. That is a
2 companion piece to the one we issued very recently which,
3 for the first time, collated a current listing of all of the
4 known owners of nuclear power plants and their operators, as
5 reflected in today's licenses as well.
6 We felt when we entered into this 18 months ago
7 that we had our data distributed throughout licenses and,
8 although it was retrievable, it certainly wasn't immediately
9 accessible so that is the foundation we have laid for those
10 two reviews.
11 One area I will mention that certainly is worthy
12 of possible further discussion is the grid reliability
13 issue. It wasn't explicitly addressed by DOE when they
14 discussed this issue with me several weeks ago but it is one
15 I think the staff has to consider for possible -- let's put
16 it this way. Putting it on the table in the short term, and
17 I look to other members of the staff to support me in that
18 regard as we go forward with DOE. My intent was to give DOE
19 a call, in fact, this morning and ask them if that is
20 something that would be appropriate in their view to add to
21 the agenda.
22 CHAIRMAN JACKSON: Commissioner McGaffigan?
23 COMMISSIONER McGAFFIGAN: May I follow up on the
24 question on the case-by-case review? I interpret what you
25 said later as industry would prefer to have a little more

1 certainty.

2 Have you considered doing a reg guide saying here

3 is one possible approach? We do that in other areas. If

4 you divert from the reg guide, you know, you are into case-

5 by-case country but if you stick to a reg guide or we

6 endorse some NEI or whatever document, FSAB document, then

7 you are in good shape, has that been thought about in the

8 restructuring area?

9 MR. WOOD: Yes, in fact we thought we did that

10 with the standard review plan and we did have a specific

11 framework for reviewing financial qualifications and --

12 CHAIRMAN JACKSON: Does that standard review plan

13 have an associated reg guide?

14 MR. WOOD: No, no it doesn't. But I think it had

15 enough detail that it provided how we actually do review and

16 the benchmarks that we do use --

17 CHAIRMAN JACKSON: Might you be able to promulgate

18 out of it a reg guide?

19 MR. WOOD: We certainly could.

20 CHAIRMAN JACKSON: Certainly, they are companion

21 pieces, aren't they?

22 MR. WOOD: We certainly could. It may be somewhat

23 redundant, but --

24 CHAIRMAN JACKSON: To try to lay, as Commissioner

25 McGaffigan says, on the table at least an acceptable

1 approach?

2 MR. WOOD: Yes.

3 We only got six comments back on the standard

4 review plans and, even among those six comments, they were

5 all from industry, and there was some divergence of opinion

6 as to the process that we were using and in a couple of

7 cases I felt that they basically agreed with it but wanted

8 some fairly minor modifications to it and in other cases

9 they felt it didn't go far enough in laying out a specific

10 position.

11 The last bullet on page 5, I think we pretty much

12 covered earlier in our remarks so I won't belabor that.

13 COMMISSIONER DIAZ: Let me ask a loaded question

14 on this instance. Since this is a new global economy, has

15 somebody even asked a question is it -- will the Atomic

16 Energy Act be changed in this respect?

17 MR. WOOD: Yeah, I think clearly there have been

18 some initiatives on the part of, or consideration at least

19 on the part of industry and others to amend the act in that

20 way to eliminate that prohibition.

21 COMMISSIONER DIAZ: How hard would that be?

22 MR. WOOD: I'm sorry?

23 COMMISSIONER DIAZ: How hard would that be?

24 MR. WOOD: I don't know how high on Congress's

25 priority list it would be.

1 COMMISSIONER McGAFFIGAN: Do we know whether other
2 nations have similar -- I know from Congress it is usually
3 if everybody else will allow American utilities to own, then
4 it is one thing. If there are prohibitions on American
5 ownership, then there is a tendency to want to be --
6 MR. WOOD: Clearly, there are a number of U.S.
7 utilities that have invested in overseas utilities so,
8 obviously, the prohibitions --
9 CHAIRMAN JACKSON: Do they own nuclear assets?
10 MR. WOOD: I think in a couple of cases they do.
11 You know, certainly this prohibition was part of the
12 security efforts at the beginning of the Cold War so, from
13 that standpoint, some of the reasons for it may be obviated.
14 CHAIRMAN JACKSON: Have we thought through what
15 would be an appropriate NRC position? You know, what the
16 policy considerations are or should be that would guide a
17 stance that we might take on the issue?
18 MR. WOOD: I don't think we have thought it out in
19 any detail on this point.
20 COMMISSIONER DIAZ: I think it might be worthwhile
21 to start thinking. If we start getting into this area to
22 have some idea which way we would go.
23 CHAIRMAN JACKSON: We have to start thinking about
24 which way we would go.
25 COMMISSIONER DIAZ: Yes.

1 [Laughter.]

2 MR. WOOD: Slide 6, please.

3 In our summary and conclusions, we have noticed
4 kind of a divergence of states. There has been some
5 acceleration or quite a bit of acceleration in several
6 states in terms of taking deregulation initiatives.
7 However, other states don't -- and those are generally
8 states with lower cost power, don't seem to have it as high
9 a priority. So most states are at least in the study phase
10 but some states are moving ahead quite a bit more rapidly
11 than other states.

12 We believe that we have taken, through our action
13 plan and some other initiatives, those actions that would
14 cope with these changes that are going on. I think we
15 believe that our current regulatory framework and
16 requirements are adequate to cope with the changes that are
17 going on, both with respect to providing assurance for
18 plant -- safe plant operations and also for safe
19 decommissioning.

20 But, obviously, we are going to have to be on our
21 toes and continuing to monitor the situation as it develops.
22 I think because of that, because each state's approach is
23 somewhat different and unique, that we have got to look at
24 how each state and their licensees in those states approach
25 the problem and make the determination as to whether they

1 actually in fact do provide adequate assurance for
2 operations and decommissioning.
3 That concludes my prepared remarks.
4 CHAIRMAN JACKSON: Commissioner Dicus had a
5 question.
6 COMMISSIONER DICUS: Yes, I wanted to address that
7 with you a little bit. On your comments which you have made
8 on the rate at which economic deregulation appears to be
9 accelerating and I think it is, and there are indications it
10 may go at an even faster rate. My base question follows up
11 on a comment or a question the Chairman had a little bit
12 earlier and I want to broaden it a bit.
13 Are we as an agency, and you have addressed this a
14 little bit, but do you really think we as an agency are
15 prepared or looking down the road far enough for this
16 accelerating rate that we can stay in front of the curve?
17 Because I think this is an area we clearly do not need to
18 fall beyond -- behind the curve.
19 MR. WOOD: Right.
20 COMMISSIONER DICUS: And things like evaluating
21 some of these unique ownership operator arrangements that
22 come up on a case-by-case basis, I tend to agree at this
23 point in time that is probably what has to occur. But when
24 three or four of these things start occurring very quickly,
25 that is very time consuming to do it.

1 My question, what are you planning, where are we
2 in ensuring we are thinking six months ahead, a year ahead
3 or whatever so that we can keep pace? Another part of the
4 question would be for example, I think I read in some of the
5 documents that we were going to be somewhat dependent if not
6 entirely dependent on the FASB standard to tell licensees
7 how to do the reporting or accounting for some of the
8 financial arrangements and that standard is clearly not
9 coming down the pike for quite some time. Can we wait for
10 that or do we not need to go ahead and be prepared on the
11 front end so that everyone knows what is expected of us?
12 I know it is a very broad question. Maybe it is
13 more of a statement than a question but I need to know where
14 we are with this.
15 MR. WOOD: I think there are two things in answer
16 to your question. The first is, we do have the default
17 framework now on this dichotomy between electric utility
18 licensees and nonelectric utility licensees and it really
19 does depend on the rate treatment they receive. We need to
20 fine tune that definition. But the basic definition and the
21 basic concept, I think, is there.
22 So I think with that and, you know, for
23 decommissioning and with our historic approach to
24 inspections for operating plants and maintaining safety that
25 way, I think we will be in pretty good shape. That doesn't

1 mean that we can't do more but I think while we are looking
2 at these things we have that already in place.
3 With respect to the FASB standard, there were two
4 elements in the action plan and there was one element that
5 was trying to do something short of rulemaking to get
6 information on the status of decommissioning funds. It was
7 almost serendipitous the way FASB's standard came out just
8 about the time of that proposal and we decided that we would
9 try to hook onto that as a good vehicle for getting that
10 information. But it wasn't the only approach we had.
11 A second element in the action plan was to
12 consider a reporting requirement that we would put in our
13 regulations and that is considered in the proposed rule that
14 you will be getting in a while.
15 So if the FASB standard doesn't go through, we
16 still have that if you agree that that is an appropriate
17 thing to do. We can have that approach too.
18 COMMISSIONER DICUS: What about resources? If we
19 get into this much more intensive effort with acceleration,
20 where do we stand with resources to cover it?
21 MR. MATTHEWS: Although that wasn't an item
22 specifically identified in the action plan, it was obvious
23 when the action plan was spawned that it was going to demand
24 additional resources, not only from the standpoint of the
25 immediate tasks that we had undertaken but as has happened,

1 there are many collateral issues that have arisen.

2 The list that I keep on my desk of things that I

3 need to look into or that the staff needs to review that we

4 haven't had time to review gets longer by the day.

5 CHAIRMAN JACKSON: Where do we stand on the human

6 resources?

7 MR. MATTHEWS: We've got two additional staff

8 members that have been hired, authorized. One is on board,

9 one will be here May 5. We have a third staff member who is

10 expected to be selected and hopefully come on board by the

11 end of the summer.

12 CHAIRMAN JACKSON: At least one or more of these

13 will be individuals with the kind of financial backgrounds

14 that we need to do this?

15 MR. MATTHEWS: We would hope they all have that

16 kind of background. They were specifically --

17 CHAIRMAN JACKSON: Well, at this stage of the

18 game, we'll take --

19 MR. MATTHEWS: No, I understand. But we have some

20 very qualified people that responded to our request. These

21 were people outside the NRC. The first two individuals that

22 we have hired came from the industry. One had a recent

23 history with Entergy and Mid South in the financial planning

24 and strategic planning area and another was an engineering

25 economist most recently working with New York Power

1 Authority but prior to that with PSE&G so they come from
2 that background and have been involved are familiar with the
3 kind of issues we are talking about in their current jobs
4 before they came to work for us.
5 CHAIRMAN JACKSON: Okay.
6 Commissioner Rogers?
7 COMMISSIONER ROGERS: No, I have no more
8 additional questions.
9 CHAIRMAN JACKSON: Commissioner Diaz, Commissioner
10 McGaffigan?
11 Thank you very much.
12 We will call the federal and state regulatory
13 panel. Thank you.
14 I think we will begin with Ms. Tomasky, the
15 General Counsel of the Federal Energy Regulatory Commission.
16 Good morning and thank you for coming.
17 MS. TOMASKY: Thank you, Madam Chairman. It is a
18 pleasure to be here.
19 CHAIRMAN JACKSON: You have to press the button.
20 Thank you.
21 MS. TOMASKY: Madam Chair, members of the
22 Commission, I appreciate very much the opportunity to come
23 here today and share with you some information about the
24 recent activities of the Federal Energy Regulatory
25 Commission. I think everyone in this room, perhaps everyone

1 in the country well knows that the FERC is strongly
2 committed to developing competitive markets for electricity.
3 Toward that end, we have initiated fundamental changes in
4 our approach to regulation.
5 These changes we expect will encourage the
6 development of competition in wholesale power markets and we
7 believe will provide very significant benefits to consumers.
8 We also believe that our rules will ensure a fair and
9 rational transition to a competitive and reliable wholesale
10 marketplace.
11 We understand that the NRC is vitally interested
12 in the potential effects of these changes on the nuclear
13 power industry. You have asked that I provide you an
14 overview today of what the Commission has been doing and I
15 would like to talk about four major policy areas of the
16 Commission's activities. These are our requirements for
17 open access transmission service, the recovery of stranded
18 costs, recent actions with respect to market-based rates for
19 wholesale sales of electricity and our merger policy.
20 I am sure you have a number of very specific
21 questions concerning the intersection of our programs and
22 yours and I look forward to discussing those specific issues
23 with you in questions after the overview and after we have
24 heard from other panelists, if you like.
25 The centerpiece of the Commission's electricity

1 policy initiatives is Order Number 888. In Order 888, the
2 Commission has required all public utilities under the
3 Federal Power Act to file nondiscriminatory open access
4 transmission tariffs. Under these tariffs, transmission
5 owning public utilities are required to provide transmission
6 service to wholesale buyers and sellers on the same terms
7 and conditions that apply to the transmission owner itself.
8 In other words, the transmission owning utility can no
9 longer restrict access to its transmission system to favor
10 its own generation.
11 To ensure that access to the transmission system
12 is not subject to manipulation, the Commission in Order 889
13 has also required public utilities to functionally separate
14 their power marketing and transmission functions. A public
15 utility is also required to have in place an Internet
16 accessible computer information system known as an OASIS.
17 This permits perspective transmission customers to know what
18 transmission capacity is available on the system and at what
19 price.
20 Open access transmission is now a fact of life
21 across the industry. There are a number of many difficult
22 issues yet to be resolved. I am sure we will be discussing
23 many of them today because they do affect the nuclear
24 industry. However, there is little dispute, I think, over
25 the fundamental principle of open access. Most

1 jurisdictional utilities have timely implemented their open
2 access tariffs and they are really busy figuring out how to
3 do business in an open access environment.
4 Let me now then turn to another critical element
5 of the Commission's open access policy, which is the
6 treatment of stranded costs. In the coming competitive
7 marketplace we believe that utilities sellers ultimately are
8 going to have to compete on the same basis as other sellers.
9 But we are also aware that in the past utility investment
10 decisions including nuclear investment decisions were made
11 under wholly different expectations and within a different
12 regulatory framework. That is, of course, the cost-based
13 regulatory framework with which you are familiar and with
14 which for many years we have regulated the utility industry.
15 There is no question that a competitive
16 marketplace and, in particular, the Commission's
17 requirements for open access create the prospect that
18 customers are going to depart the system. The consequence
19 of them leaving the system is that some of the costs
20 associated with the utilities providing power to their
21 traditional customers can be stranded. There is no question
22 that the stranded cost issue, which is the price tag for
23 open access in our view, is the most hotly contested issue
24 associated with Order 888.
25 In Order 888, the Commission studied thousands of

1 pages of comments on this issue from over 400 commentors and
2 we came to the conclusion very firmly stated several times
3 in various iterations of the rule that utilities should be
4 given an opportunity to recover all verifiable and prudently
5 incurred stranded costs. In our view, stranded costs
6 associated with the rule are costs that occur when a
7 customer departs the system and then uses the supplier's
8 transmission system to access new supplies.
9 Recovery of stranded costs from a particular
10 customer is going to be determined on a case-by-case basis
11 under the Commission rules and, as a result, many of the
12 questions I think we will likely explore today about what
13 stranded cost recovery really means we expect to evolve in
14 the case-by-case process. As a general matter, the utility
15 will bear the burden of demonstrating that it had a
16 reasonable expectation of continuing service beyond the term
17 of a contract in order to receive what we call the extra
18 contractual stranded cost recovery.
19 But I think it is important to note that the
20 Commission in Order 888 did not abrogate existing
21 requirements contracts so that customers who are obligated
22 contractually to stay on the system would do so and continue
23 to bear their cost responsibility. Again, on a case-by-
24 case basis, the Commission could consider opening up those
25 contracts and, in that context, we would expect to deal with

1 the stranded cost issues if we were going to permit the
2 customer to depart that system early.
3 Clearly, we think that a fair transition to
4 competition includes stranded cost recovery but, as the
5 prior panel's discussion, I think, made very clear, the vast
6 majority of stranded costs are likely to be generation costs
7 incurred to serve retail load that will be stranded as a
8 result of state retail choice programs and, as a result, the
9 vast majority of the challenges involved in dealing with
10 stranded cost issues are going to fall to the states.
11 We have done a number of things in Order 888 that
12 we think accommodate the states' move to retail access if
13 they chose to do so and we have certainly encouraged the
14 state commissions to address these issues up front as they
15 proceed with retail choice.
16 Let me mention briefly the FERC's policies
17 governing market-based rates for wholesale sales of
18 electricity. For several years now the Commission has been
19 ruling on applications of wholesale sellers including power
20 marketers to sell electric power at market-based rates. We
21 have some complicated proof procedures that are required for
22 utilities who need to demonstrate the lack of generation
23 market power in order to sell from existing generation but
24 we do have a number of utilities including some nuclear
25 utilities who are selling off system at market-based rates.

1 We generally expect this trend to continue. Our
2 review process for market-based rates really has to do with
3 issues of generation market power, whether or not we believe
4 that if a seller sells into a particular market it is likely
5 to dominate that market and therefore it will be able to
6 elevate the price for a sustained period of time. If we are
7 satisfied that generation market power is not present, we
8 will permit -- or it has been mitigated, we will permit the
9 seller to move to market-based rates.
10 Let me mention one last area which is the
11 Commission's actions with respect to its merger policy which
12 your staff had indicated that you had an interest in.
13 In December 1996, the Commission issued a
14 statement of policy that will govern future review of
15 applications for public utility mergers. We are doing a
16 fairly brisk business in merger application review recently.
17 It is certainly something that many in the utility are
18 understandably turning to and is something that business
19 typically turns to under -- when economic circumstances
20 change in order to realign themselves in order to face new
21 challenges. That is something that our Commission certainly
22 expects from the utility industry.
23 We do not want to discourage that. At the same
24 time, mergers that actually reduce the number of sellers in
25 a marketplace do have the possibility of raising competitive

1 concerns. We have worked for a number of years attempting
2 to open up these marketplaces to a variety of sellers so it
3 is natural that we would want to look at these mergers to be
4 satisfied that the anticompetitive effects are not so
5 significant that the merger should be disapproved.
6 The merger policy statement lays out the criteria
7 by which we are going to evaluate these mergers in some
8 detail. I think it provides expedited procedures for
9 mergers that don't raise competitive concerns and it also
10 provides hearing and other procedures and certainly a more
11 scrupulous inquiry where our initial screen suggests there
12 are concerns.
13 The last issue I want to mention, Madam Chair, has
14 to do with the issue of reliability which I know you have
15 addressed extensively yesterday. The FERC very much
16 supports the efforts of the North American Electric
17 Reliability Council to take the lead on reliability issues.
18 There are some challenges, unquestionably, that
19 restructuring of the utility industry will pose and we have
20 certainly encouraged NERC to take the lead in attempting to
21 address them.
22 The Chair of our Commission recently testified
23 before Congress on these issues and she stressed in
24 particular her concern with the fact that NERC membership is
25 not mandatory. She recommended that Congress ought to put

1 the FERC in the position of ensuring that NERC standards do
2 become mandatory and to be able to provide mechanisms for
3 enforcing those standards and for compliance. We do not
4 have a specific proposal on this issue and we have again
5 continued to encourage the efforts of NERC to open up its
6 memberships to all the likely participants in power markets
7 so these issues can be addressed.
8 That concludes my general remarks. Madam Chair,
9 members of the Commission, I would be happy to answer
10 questions.
11 CHAIRMAN JACKSON: Thank you very much. I think I
12 would like to ask you a couple of questions.
13 With respect to FERC's position on the stranded
14 costs issue, and you mentioned a case-by-case approach and
15 your prepared, submitted remarks spoke of FERC as being a
16 forum for stranded cost disputes, would you expect to have
17 explicit consideration of decommissioning funding costs as
18 part of your consideration of stranded cost issues?
19 MS. TOMASKY: We certainly would, Madam Chair.
20 The Commission did mention in Order 888 and in our rehearing
21 order that we believed that nuclear decommissioning costs
22 were appropriately considered to be stranded costs and would
23 be dealt with on a case-by-case basis. I would imagine as
24 those case unfold we would continue to observe the
25 traditional relationship with your Commission. I do not

1 imagine that our Commission has any interest in second-
2 guessing issues of how decommissioning occurs.
3 We have traditionally looked at, in determining
4 how decommissioning costs are put into rates now, we have
5 traditionally looked at issues, the estimates, and those are
6 frequently litigated amounts. We actually just set for
7 hearing a case involving Connecticut Yankee in which we
8 expect those issues to be resolved.
9 That was not a classic stranded cost case, a
10 restructuring stranded cost case in the sense that departing
11 customers were leaving the system and therefore we were
12 being asked to address how to tread nuclear decommissioning
13 costs in that context. But I have every confidence that our
14 Commission takes that very seriously and we would expect
15 those issues to be worked out along with others in these
16 proceedings.
17 It is, admittedly, a somewhat more difficult issue
18 than simply attempting to figure out what the present value
19 is of a remaining obligation, reduce it to a current form
20 and then decide how it is going to be paid. We understand
21 that there are uncertainties.
22 But I just want to stress that we had enormous
23 success in the natural gas restructuring with settlement of
24 many of these issues. We have in fact in front of us a case
25 with NEPCO that is currently in hearing and I understand

1 that technical conferences with an eye or a hope for
2 settlement are going on and that many of those -- that
3 indeed involves a dramatic restructuring of the buyer/seller
4 relationships for that company and we are very hopeful that
5 these issues will be resolved.
6 CHAIRMAN JACKSON: Do you have a position with
7 respect to the issue of foreign ownership control or
8 domination, as you know, the different business forms occur?
9 MS. TOMASKY: Our Commission doesn't have a
10 position with respect to that. If I could interpret a bit
11 from our merger policy statement, I can say that it is
12 something that gave us very little concern. We believe and
13 fully expect that ownership is going to move all over the
14 place, quite frankly, with respect to the electric utilities
15 and we think that the movement of capital is a pretty good
16 thing.
17 We do not attend to issues of national security as
18 you do. Not that we don't think they're important but we
19 understand it is your job, not ours. And those are the
20 kinds of things that would inform those kinds of concerns.
21 What we have dealt with in the context of foreign
22 investment have been issues of reciprocity with respect to
23 transmission access. Those are policy concerns that are
24 pertinent to us and our considerations.
25 We also understand, obviously, that the SEC

1 regulates sort of quantities of investments and there are
2 issues with respect to foreign holdings under the Public
3 Utility Holding Company Act but that is not something that
4 our commission has gotten into and, quite frankly, given our
5 focus on competitive concerns and concentrations of
6 generation market, it may well be that the farther away the
7 merging entity is from the utility the better our Commission
8 likes it.
9 CHAIRMAN JACKSON: You mentioned that FERC should
10 have the authority to make, for instance, compliance with
11 NERC standards mandatory. This is on the issue of grid
12 reliability, et cetera.
13 Have you proposed, and I think maybe you did
14 address this but I am going to ask again, specific
15 legislative language that relates to any kind of a federal
16 backstop for NERC's activities and actions?
17 MS. TOMASKY: We have not proposed specific
18 legislation. We have certainly recommended to the
19 Department of Energy that they address these issues and I
20 would expect that the Chair of our Commission who we expect
21 to be headed that direction will carry that general policy
22 initiative with her.
23 I do understand that it has been very much on
24 DOE's mind. There are lots of debates that go on about how
25 much authority we do and don't have. We had suggested that

1 we be the repository for it because we have certainly
2 attempted to recognize NERC standards in the context of our
3 open access tariffs and, in recent discussions with DOE, as
4 they were talking about downsizing, they seemed to want some
5 of the interconnection authority that they have, or at least
6 they were discussing the possibility of interconnection
7 authority with the FERC. It is a job we think we can do.
8 We do not have specific legislation in mind and I assume
9 that the ultimate formulation will work its way through with
10 the Administration interagency review process.
11 CHAIRMAN JACKSON: Do you have any specific
12 positions with respect to ISOs, their formation, membership,
13 mandating their formation, et cetera?
14 MS. TOMASKY: Our Commission was encouraged, in
15 the context of Order 888, to mandate ISOs as a means to
16 remedy undue discrimination. In essence, to separate the
17 generation function from the transmission function. We
18 decided not to do that.
19 We went a regulatory path that we call functional
20 unbundling where we required that as an operational matter
21 that the generation and transmission functions be separated
22 within a utility and impose standards of conduct to be
23 imposed by employees to ensure that that separation was
24 effective. Nevertheless, the Commission has strongly
25 encouraged the formation of ISOs and the investigation of

1 ISOs, particularly in the context of the reform of tight
2 power pools, which is going on in several regions of the
3 country.
4 We have ordered the tight power pools to
5 restructure their transactions to unbundle transmission and
6 generation transactions and also to address other aspects of
7 our undue discrimination rules and most of them are turning
8 to some form or the other of ISOs to go forward. There are
9 legitimate -- you know, ISOs are a dream in pursuit of
10 realization in a lot of parts of the country and we think a
11 very useful dream. There are legitimate debates over
12 whether an ISO makes sense except on a broad regional basis
13 and certainly in terms of pricing efficiencies and
14 operational efficiencies, we see a lot of benefits in ISOs.
15 We have been asked to mandate it. We have
16 declined to do so, so far. The issue of mandating ISOs
17 arises in several merger cases we have and that is another
18 context in which we would examine them. So I guess the
19 short way of saying it, we think they are a good thing and
20 we are doing our best to encourage them but we haven't
21 mandated them yet.
22 CHAIRMAN JACKSON: Okay. Let me ask you one last
23 question for the time being.
24 We are North America.
25 MS. TOMASKY: Yes.

1 CHAIRMAN JACKSON: And that implies
2 interconnectivity of the electrical network to the north and
3 to the south. Are there any government-to-government
4 activities or initiatives that need to occur to deal with
5 the issue? Again, I am thinking from our point of view
6 having to do with the interconnectivity and its effect on
7 the reliability of the grid.
8 MS. TOMASKY: Well, first of all, we absolutely
9 agree with you and I think while we do not believe, I think
10 that there are specific issues associated with restructuring
11 and reliability that are critical, clearly exchange of
12 information is absolutely essential.
13 We would like to see and have taken some steps to
14 try to encourage the Canadian provinces and the publicly
15 owned utilities up there to make open access a rule of law
16 for them as well. We -- in particular, if they are trying
17 to do business in the United States and marketing their
18 power down here.
19 We have essentially imposed a reciprocity
20 requirement, a do-unto-others requirement, in effect. If
21 they want to do business down here, they have to make their
22 transmission systems available. We would like to see
23 dialogue on those issues.
24 With respect to reliability, it seems to me that
25 NERC is quite aware of the interconnection issues and we

1 have, although we have challenged NERC in a number of
2 significant respects to open up their membership, to attempt
3 to evolve their standards to meet some of the new and
4 different issues associated with restructuring, for example,
5 the multiplicity of sellers that they will be facing moving
6 power into the grid, the issues that I know have been
7 identified by you, Chairman Jackson, over the question of
8 incentives for maintenance.
9 But we ultimately believe that NERC needs to take
10 the lead and that the FERC has appropriately a follow-up
11 role in enforcement.
12 CHAIRMAN JACKSON: Commissioner Rogers, Dicus,
13 Diaz?
14 COMMISSIONER DIAZ: Based on what little I know
15 about Mexico's grid and rates, has a thought come through
16 about the difficulty there would be to bring Mexico into
17 some common standard as far as free market? Because they
18 really don't.
19 MS. TOMASKY: I know about this, Commissioner,
20 only anecdotally, actually. We have had some conversations
21 with Mexican officials who have come to our Commission
22 seeking sort of structural advice on how to deal with rate
23 regulatory issues.
24 I know that they are attempting to make some
25 progress but I understand it is a very difficult and slow

1 process there. They have very significant infrastructure
2 issues that would make -- that have raised some concerns
3 about interconnection with the United States. I also know
4 that there is a lot of interest in simply locating power
5 plants along the border to move power into the United States
6 and that that has created some environmental controversies.
7 But I do not know of a systematic approach to
8 these issues other than, I think, the very good faith
9 efforts of Mexican regulators to try to develop a regulatory
10 system for them that makes sense.
11 COMMISSIONER DIAZ: Thank you.
12 CHAIRMAN JACKSON: Commissioner McGaffigan?
13 COMMISSIONER McGAFFIGAN: To follow up on the
14 Chairman's question, you basically are proposing that NERC
15 membership be made mandatory in this country and that there
16 be an enforcement and compliance mechanism that is also
17 mandatory through NERC. My recollection yesterday is that
18 we have most of Canada and just a little piece, around
19 Tijuana or whatever, of Mexico in NERC.
20 Does Canada have to do the same thing in terms of
21 mandating NERC membership and mandating that if we want to
22 ideally get the system, mandating a compliance structure? I
23 think to just be more specific in following up the
24 Chairman's question.
25 MS. TOMASKY: To be fair, Commissioner, I don't

1 know that we have or that Chair Moler has formed a view. We
2 certainly have been reluctant to tell Canada what to do in
3 terms of handling these issues. But I certainly see the
4 benefits of symmetry are certainly attractive.
5 The issues aren't going to change when you go
6 north of the border. I do not know that Canada is facing
7 the same questions associated with restructuring but I would
8 also emphasize that the reliability issues that have come to
9 attention recently are not necessarily associated with
10 restructuring. The outages that happened in the West, for
11 example, have nothing to do with the Commission's
12 restructuring initiatives or, for that matter, the proposed
13 restructuring initiatives in California.
14 So the reliability issues are there. They don't
15 stop at the border and it strikes me that the prudent thing
16 to do would be to engage in discussions with the Canadian
17 government if our administration decides that is the right
18 course, to let them know what is going on and to suggest to
19 them that comparable requirements on the other side could be
20 useful.
21 COMMISSIONER McGAFFIGAN: The other question I
22 have is you regulate wholesale transmission and you are very
23 careful to point out that on the retail side, that's the
24 states' responsibility. Although in a paragraph you didn't
25 read, you said there is work to be done on the federal/state

1 relationship.

2 If you go to the decommissioning cost issue, when
3 you look at an individual case, are you looking at the part
4 of decommissioning costs which you say in your statement is
5 the smaller part that relates to wholesale and what is the
6 mechanism for looking at the total, the totality of
7 decommissioning costs? If you are regulating 10 percent and
8 the states are regulating 90 percent, how does that work?

9 MS. TOMASKY: The answer -- the simple answer to
10 your question is, yes, we have the small piece of it. The
11 larger answer to the more important piece of your question,
12 which is how does it all work together, is we've got to
13 figure that out.

14 We actually have jurisdiction over transmission in
15 interstate commerce, which would actually include unbundled
16 retail transmission. But with respect to stranded costs,
17 the critical jurisdictional issue under Order 888 is
18 jurisdiction over the generation.

19 We basically regulate wholesale sales and, as a
20 result, costs incurred to serve wholesale requirements
21 customers and coordination customers are the basically are
22 the kinds of utility costs that we are talking about and
23 that we regulate. It is a small piece of the pie. There is
24 no question about that.

25 With respect to some utilities, some nuclear

1 utilities have structured themselves as wholesale suppliers
2 and, in those cases, those issues come before us entirely
3 and we would handle --
4 COMMISSIONER McGAFFIGAN: Connecticut Yankee is
5 that sort of case, isn't it?
6 MS. TOMASKY: Yeah, the NEPCO case is an example
7 of that. There are -- most of the utilities around the
8 countries, however, are not structured that way. State
9 commissions can intervene in our proceedings. We have
10 indicated that in the context of state restructuring
11 proposals, we would give considerable deference to what the
12 states do.
13 I don't think there is going to be a big overlap
14 but there may well be questions of how to deal with gaps in
15 the numbers between what the states would do and what we
16 would do.
17 The Commission traditionally on costs, we have
18 dealt with these things strictly as cost allocation issues.
19 It is not, in that sense, a new rate issue for the
20 Commission. Generation facilities are often shared and we
21 do an allocation that we think makes sense and states do an
22 allocation that they think makes sense and sometimes it adds
23 up to more than 100 percent and sometimes it adds up to a
24 bit less.
25 We are probably going to have to pay a bit more

1 attention to that number in the context of nuclear
2 decommissioning and I would expect that to certainly be
3 something that would be pursued. I also do expect, though,
4 that as you have seen, that most of these restructuring
5 proceedings that states undertake are going to, if they are
6 done with the full cooperation of the utilities and the
7 local parties, they are going to end up with a solution to
8 these issues and something that our Commission could easily
9 defer to if there were a settlement or at least something
10 approaching a settlement that appeared to make sense.
11 CHAIRMAN JACKSON: At this point, is FERC
12 considering any additional actions or any legislative
13 changes that would clarify the issues? I guess I am trying
14 to get you to elaborate a little even beyond what you have
15 already done on the clarification of questions of state
16 versus federal responsibilities.
17 MS. TOMASKY: There are some issues that I
18 don't -- don't necessarily go to the issues of stranded
19 costs that we have been interested in having dealt with in
20 legislation. I think that it would probably be useful for
21 me to elaborate a bit on the kind of jurisdiction that FERC
22 is asserting under 888 because it is a matter of some
23 controversy. It is not categorically true that we would
24 never deal with retail stranded costs. Essentially what we
25 said was that stranded costs arising from the departure of a

1 wholesale customer is our job.

2 If we had indicated that there is a gray area,
3 which is what happens when a previously retail customer
4 leaves the retail system, becomes a wholesale customer
5 through a municipalization or something like that, and
6 strands retail assets, in that circumstance, our Commission
7 has determined that it would assert primary jurisdiction
8 with respect to the recovery of those stranded costs.

9 The theory for doing that is that we believe that
10 the stranded costs are the result of the availability of
11 open access tariffs that the Commission created. If there
12 were not open access tariffs available, the municipalization
13 and the opportunity to leave the system would not be
14 available. And on that basis, the Commission has indicated
15 it would assert primary jurisdiction there although, of
16 course, if a state had already acted to deal with the
17 stranded cost recovery in some fashion we wouldn't permit
18 double recovery on the part of the utility, we would deal
19 with it through some sort of crediting mechanism.

20 With respect to what we call pure retail stranded
21 costs which are occasioned by a state retail access program,
22 we have indicated that the only instance in which we would
23 step in would be to fill a regulatory gap where the state
24 commission determined it lacked authority to deal with this.
25 I should point out that all of the states that have been

1 pursuing retail access programs thus far have understood
2 that the stranded cost issue was an important one and one to
3 deal with and dealt with up front and so there hasn't been
4 any occasion for people to come to us and say, it's time for
5 you to get involved.
6 We also tried to make clear in 888 that we weren't
7 a forum for second guessing the substantive decisions of the
8 state but, simply, a forum to deal with stranded costs if
9 the state lacked the authority to do so. So that is the
10 context, sort of the detailed context that I have sort of
11 broadly summarized before.
12 CHAIRMAN JACKSON: Right, thank you.
13 You know, FERC and the NRC have established a -- I
14 could have called it NURC but it would have caused
15 confusion -- a valuable working relationship and it has
16 allowed us to share safety concerns with you as you make
17 your economic regulatory decisions. And it has been
18 effective, we think, to the NRC in addressing areas of
19 mutual interest.
20 But do you see any additional steps that might
21 need to be taken to assure that areas of shared concern are
22 incorporated in our respective policies and are there any
23 areas of overlap or duplicative review that you think could
24 be eliminated to provide more efficient and effective
25 regulatory oversight in these areas?

1 MS. TOMASKY: Well, I totally agree with you,
2 Chairman Jackson, that we have taken the most important step
3 which is that we are now talking to each other a lot and our
4 staffs continue to talk and I know the discussions that have
5 happened recently where we just explore issues and come to
6 an understanding have actually revealed, I think, that there
7 are fewer problems than people might think in ensuring that
8 your responses to competition and our responses to
9 competition are entirely consistent.
10 I think that in terms of potential overlap, I
11 think that when we get into case-by-case determinations of
12 stranded costs and decommissioning that the NRC undoubtedly
13 has a vital interest and we would expect to hear from you
14 from those cases, in those cases, and we certainly would
15 value your contribution and your judgments very highly in
16 those cases. We have, I am sure you well know, rigid rules
17 about ex parte communications and things like that but,
18 within, we can certainly work out appropriate ways for you
19 to contribute your views in those cases and I think it would
20 be very useful. Yes, there is always a potential conflict,
21 potential for conflict, but I think that they are completely
22 reconcilable.
23 There has been a lot of talk in terms of overlap
24 about your antitrust review and our competition review. I
25 do not have a judgment as to whether or not one or the other

1 is duplicative. I know we think ours is pretty valuable and
2 we would like to hold onto it. As to whether or not you
3 believe that your antitrust review remains appropriate, let
4 me emphasize that we have never found it to conflict with
5 the exercise of our jurisdiction in any way.
6 I think that my understanding of some of the open
7 access license conditions with respect to transmission have
8 probably been overtaken by our open access tariffs. I
9 understand most of them to be company and perhaps even
10 transaction specific and our open access tariffs which are
11 available to all comers are probably the best way to move
12 power right now under a tariff. I think that is what most
13 people are doing.
14 I think that, ultimately, you are in the best
15 position to judge and to recommend to the Congress the
16 enduring validity of your antitrust considerations.
17 CHAIRMAN JACKSON: Thank you.
18 Further questions?
19 I think we will -- we don't mind if you stay.
20 MS. TOMASKY: I'm happy to stay. Thank you.
21 CHAIRMAN JACKSON: I am going to turn to
22 Mr. Ellsworth, president of NARUC, to talk about your part
23 of the presentation.
24 MR. ELLSWORTH: Thank you very much Chairman
25 Jackson, members of the Commission. On behalf of NARUC, we

1 appreciate the opportunity to come and share with you our
2 overview of the status of restructuring among our members.
3 If it is acceptable to you, the presentation this
4 morning will be made by Commissioner Gee of Texas, who
5 chairs our Committee on Electricity. Commissioner George
6 from Iowa who chairs our subcommittee on nuclear issues and
7 I will stand ready to answer any questions that you may have
8 of us following Commissioner Gee's presentation.
9 CHAIRMAN JACKSON: Thank you.
10 MR. GEE: Thank you, Chairman Jackson and members
11 of the Commission.
12 It has been almost a year since the NARUC
13 leadership had an opportunity to visit with you to talk
14 about restructuring activities and I think it is fair to
15 say, as you know, based upon the presentation of your staff
16 this morning, much has occurred.
17 CHAIRMAN JACKSON: Yes. And I must say, I have to
18 insert, and you knew I was going to zing you on this,
19 because I think when we met you said nothing much is going
20 to happen for a while.
21 [Laughter.]
22 CHAIRMAN JACKSON: So I just had to put that onto
23 the table.
24 MR. GEE: There is a lesson there; never say
25 never.

1 In fact, a great deal has occurred and I would
2 like, in a few brief moments today, just to hit the high
3 points or our prepared statement so that we can entertain
4 questions that I know that you have of President Ellsworth
5 as well as Commissioner George with respect to what has
6 happened.
7 Since we last met with you, the National
8 Association of Regulatory Utility Commissioners has adopted
9 a statement of principles to guide our member commissions in
10 the path of restructuring and that is accompanied in our
11 prepared remarks today. It sets out some guideposts as a
12 recommendation for our member commissions to follow as they
13 go about the process of restructuring. You will note that
14 it touches upon such critical matters as maintenance of
15 reliability in a restructured market, the need for states to
16 address fairly and equitably the concerns related to
17 stranded costs as well as maintaining the imperatives of
18 continuing to provide universal service to all customers.
19 Since we last met, 10 states have adopted statutes
20 or the state commissions already have proposed reforms to
21 restructure the retail markets. Nine of these 10 have acted
22 within the last 10 months. This represents fully one-third
23 of our nation's population which is now being subjected to
24 significant restructuring of these retail markets.
25 I am told and my information that we provided to

1 you so indicates that all states except one in the United
2 States are at least considering or have already adopted
3 reforms of retail markets. That single state that has not
4 done so, I believe, is Tennessee which, as you know, is
5 generally made up of the Tennessee Valley Authority, which
6 is not subject to state regulation.
7 Generally, restructuring has occurred initially
8 from what are known as high-cost states, that is states that
9 have a great deal of embedded generation cost that are above
10 current market prices. The process began generally in the
11 northeastern states as well as California. Since then,
12 however, a number of what are known as low-cost states have
13 also begun taking the initiative.
14 I would update our prepared remarks to inform you
15 that since we prepared our remarks the state of Oklahoma,
16 its legislature, both the house and the senate, have
17 approved a bill that would open up their retail markets by
18 the year 2002. It is anticipated that their governor will
19 probably sign that into law within the next 30 days. Also
20 the legislature of the state of Montana also has adopted
21 restructuring legislation, also to provide for retail
22 competition by the year 2002.
23 Those two states are generally known as low-cost
24 states. They have some flexibility by way of moving to open
25 up the retail markets primarily because they bear minimal

1 stranded cost concerns. Neither state, I am told, has any
2 nuclear power capacity and I believe that they are moving
3 forward to open up their retail markets in order to provide
4 competitive opportunities because they see that that is
5 generally the trend that is occurring in those states that
6 have higher cost responsibility.
7 My own state is also within the category of states
8 that are low cost. There are bills that are being actively
9 debated and considered as we speak in my state legislature
10 and the time frame that is under discussion is around 2001
11 and 2002 by which my own state may open up its retail
12 markets.
13 Turning to the critical issue of stranded costs,
14 as I indicated, NARUC's position is that its member
15 commissions should all address fairly and equitably the
16 concerns raised by utilities with respect to their having
17 incurred verifiable stranded costs that would be rendered
18 uneconomic in a competitive market. With respect to the
19 nuclear industry, as you know, those stranded costs
20 generally fall in two categories, those representing
21 embedded fixed plant costs and decommissioning costs.
22 The critical question being addressed at the state
23 level as they move about restructuring is to what extent
24 should such costs be placed -- the recovery of such costs be
25 placed at risk in the market or should there be other

1 mechanisms to make more certain the cost recovery for those
2 concerns.
3 I am pleased to report and I believe your staff
4 alluded to this that two states that have addressed the
5 question of decommissioning cost recovery, California and
6 Pennsylvania, have opted to maintain the revenue stream for
7 collection of those costs through a nonbypassable wires
8 charge. I am told that in California that is already
9 explicitly provided for in their statute.
10 In the Pennsylvania case, the statute provides the
11 commission to make a determination of the extent to which
12 those costs should be included in a nonbypassable wires
13 charge. That decision, as I understand, is still pending.
14 It has not been made yet but it is certainly something that
15 is critical on the agenda within the state of Pennsylvania
16 to address.
17 I think it is fair to say that in my conversations
18 individually with state regulators as to the activities
19 going on in their commissions, each of them places a very
20 high priority on the continued recovery of decommissioning
21 costs under any restructured scheme. In terms of critical
22 issue priority, I would say that is probably at the highest
23 level, among the highest levels if not the highest level in
24 all of the restructuring discussions.
25 Additionally, measures to address the fixed cost

1 recovery concerns associated with restructuring have also
2 been addressed by either the state commissions or the
3 legislatures. One means of addressing a potential
4 uneconomic fixed plant cost is to accelerate those costs.
5 That is a measure that has been undertaken in California. I
6 believe also South Carolina has opted for that approach to
7 ease the transition.
8 In my own state, even though our legislature has
9 not yet decided to open up its retail markets, our
10 commission has made a decision in one major utility case to
11 permit acceleration of potentially stranded costs on a
12 current basis to ease the transition to the potential
13 competition in retail markets.
14 Another measure being used to provide for better
15 means of cost recovery is the concept of securitization. I
16 know you have a presentation on that later today. Suffice
17 it to say at least two states have already adopted that
18 approach.
19 The state of California has adopted an approach
20 whereby the state has enacted a statute that provides for
21 the backing, the assurance of a revenue recovery through a
22 competitive transition charge. That would enable the
23 utility to sell an asset of a revenue stream representing a
24 share of these uneconomic costs in order to be able to
25 recoup a measure of cash in order to buy down those

1 uneconomic costs.

2 The state of Pennsylvania also has adopted a
3 similar approach and it is my understanding that this
4 approach is being under -- is under consideration in a
5 number of states and state legislatures where restructuring
6 is being contemplated.

7 Also, again, returning to the issue of
8 decommissioning, NARUC itself as an association is placing a
9 high priority on attempting to provide its members guidance
10 with respect to the treatment of decommissioning costs in a
11 restructured environment. We are currently within NARUC
12 attempting to put together a dialogue on decommissioning
13 cost recovery in a restructured market.

14 As part of that dialogue, we have directed our
15 staff to come up with an issues list and to make
16 recommendations on what would be the proper forum by which
17 we could gain a broad-based cross-section of representation
18 of all interests to see if a consensus can be reached within
19 a collaborative forum to make some recommendations that our
20 member commissions could use as guide posts. Your staff is
21 part of that process within the NARUC staff. We welcome
22 their participation, we think it is critical.

23 Commissioner Emmit George is leading that process
24 and I am sure he can fill you in on the details. We do
25 anticipate that that dialogue will be getting under way

1 within a matter of the next few months.

2 Finally, in closing, let me address some of the
3 matters with respect to the concerns of reliability and also
4 with respect to adoption of the approach, as we have seen,
5 of adopting an independent system operator. I know that you
6 devoted a great deal of time to the question of reliability
7 in your workshop yesterday and I won't cover new ground.

8 NARUC has not yet taken a position endorsing the
9 concept of an independent system operator. There have been
10 a number of our member commissions that are active in NARUC
11 that have individually endorsed the concept of an
12 independent system operator that is truly independent from
13 the ownership and control of transmission owners.

14 One of the critical concerns in moving toward
15 adoption of an ISO approach is the question of what is truly
16 independent and I know that that is a matter that is under
17 debate in various forums since there is no common model of
18 what an independent system operator ought to look like.

19 Another concern I have heard is the question of
20 how does reliability mesh, the imperatives of reliability
21 mesh with the desires to shift control and operation away
22 from those that own the transmission grid to a new entity
23 that does not have ownership but may well have
24 responsibility for also playing a part in maintaining
25 reliability through dispatch decisions. That is also an

1 issue that I know is being addressed in a number of areas
2 where the discussion of how the shape of an ISO is to occur,
3 how can reliability be maintained consistent with the need
4 to attain a measure of independence of control of the grid
5 apart from ownership.
6 In my own state, in Texas, we adopted a rather
7 simplified approach to that because we have a reliability
8 council that is wholly contained within our state. We
9 simply allowed our reliability council to become the
10 independent system operator. That approach has worked well
11 thus far but we are closely monitoring that to ensure that
12 all concerns of the users of the grid are met and are
13 handled in a manner which is perceived by them, anyway, to
14 be done in a fair and nondiscriminatory basis.
15 Again, let me thank you for the opportunity to
16 address you today. As I indicated previously, we appreciate
17 the continued participation of your staff in NARUC's efforts
18 to give us guidance on the imperatives of your Commission as
19 we attempt individually to try to address these critical
20 concerns of restructuring our retail markets.
21 I am available to answer questions as are
22 President Ellsworth and Commissioner George.
23 Thank you.
24 CHAIRMAN JACKSON: Thank you.
25 Let me preface my questions to you with a comment

1 which I probably should have prefaced everything with today.
2 And that is that in a certain sense we have a nice, clean
3 task. You know, we are health and safety regulators and so
4 we are trying to ensure that our issues are dealt with
5 because if they aren't then that triggers the need for us to
6 take some action the way we can, which is with respect to
7 our licensees.
8 In doing that, and this is as much a comment as a
9 question to you, have you considered that in a certain
10 sense, in mandating competition, that to the extent that
11 there aren't either transition or overarching strategies for
12 dealing with what are health and safety related issues, that
13 in the end you propagate into how competitive an environment
14 you will or will not have?
15 What am I saying? I am saying, for instance, if
16 we take the issue of decommissioning costs, that that is
17 something that absolutely we have a responsibility to ensure
18 is available. It is ultimately a health and safety issue
19 and it is an issue that impacts your individual states.
20 That is, to see the nuclear facility is completely and
21 appropriately and safely decommissioned.
22 If, in fact, there aren't strategies to either
23 create continuing revenue streams and the like, that
24 triggers requirements we have to place on the nuclear
25 utilities. If that is the case, one could argue that that

1 puts them at a competitive disadvantage. I am dealing
2 strictly with the narrow issue of decommissioning costs as
3 opposed to the larger issue of stranded costs. But it is
4 something that is an absolute health and safety requirement.
5 So I just kind of give you that, you know, in the
6 background.
7 So my question, first question to you is, what
8 are -- you mentioned NARUC guidance to its members with
9 respect to decommissioning costs. What are the key elements
10 of that guidance as it has evolved to this point?
11 MR. GEE: Right now, our efforts are only
12 informative because we are attempting to catalogue the host
13 of different policy concerns related to restructuring as
14 they may affect decommissioning costs.
15 I can say that among them would include,
16 automatically with or without restructuring, the sufficiency
17 of decommissioning cost funding and whether, in a
18 restructured environment, which might lead potentially to
19 premature retirement of plant, whether we would aggravate
20 what might already be an insufficient level of funding that
21 has been accrued in a going-forward basis. That is of deep
22 concern to many of us who have not yet made the
23 restructuring call in our individual states and would like
24 to look, by way of example, to what is being done in other
25 states to address both the sufficiency of existing funding

1 as well as maintaining a common level of guaranteed funding
2 in a restructured environment, such as the adoption of an
3 approach as in California, for instance, and whether that is
4 the way that most states ought to be headed as they open up
5 their markets for retail competition and decide that a
6 measure of generation is going to be placed within the
7 market and susceptible to market forces.
8 We are hopeful that we can identify these issues
9 and then from that make recommendations to our member
10 commissions who have not yet made restructuring decisions
11 that they can then take back to their respective state
12 legislatures who, ultimately, are the ones that have the say
13 so, whether or not to open up retail markets, and that those
14 recommendations can be given sufficient weight or a heavy
15 degree of weight in any restructuring proposal that is
16 ultimately adopted by state legislature.
17 Commissioner George, I think, can speak more
18 specifically on some of the issues that have already come up
19 on the screen with respect to decommissioning funding that
20 our staffs, our respective staffs, are looking into.
21 MR. GEORGE: I think that the issue that brought
22 this to our attention and I dictated that we needed to
23 address the notion of decommissioning in a generic sense was
24 the conference in Ft. Meyer last January.
25 There was a presentation there by one of the

1 speakers with regard to the tax credit associated with
2 decommissioning and if there is accelerated decommissioning,
3 as has occurred in California, that a company would not be
4 able to recover the accelerated cost but would have to only
5 take the depreciation over the planned life of the facility.
6 That raised the question that there are a number
7 of issues surrounding decommissioning that commissioners
8 will have to face as we go forward with this process. Many
9 states have not taken any action or addressed these issues
10 in any way while several have actually gone through
11 legislation.
12 But what I suggested is that we needed to sit down
13 and identify all of the issues and, in terms of the guidance
14 that Commissioner Gee suggests NARUC gives to its
15 membership, that that guidance is or at least in this
16 instance will be an identification of what the issues are
17 and a discussion of what the potential resolutions might be,
18 leaving to the state commissions or state legislatures the
19 policymaking decisions in the final analysis as to how they
20 might proceed.
21 It is an opportunity and an effort to inform as
22 opposed to direct what is done at the state level.
23 CHAIRMAN JACKSON: What kind of time line are you
24 operating on to come forward with this guidance?
25 MR. GEE: We initially thought that we might start

1 this process prior to our summer meeting in July. Whether
2 that occurs or not really will depend on our full
3 electricity committee which this matter will be presented to
4 within the next 30 days. We have actually discussed it at
5 that level but a formal presentation will be made to them in
6 the next couple of weeks.
7 CHAIRMAN JACKSON: This is an example of where
8 there is a nexus between the issue. You know, your
9 consideration in the economic realm, such as a tax credit
10 for decommissioning costs, and how that might get impacted
11 by an accelerated amortization schedule for decommissioning
12 funding because that, in fact, is something that we would
13 have to consider for those entities that no longer meet our
14 definition of an electric utility. In a certain sense, it
15 is already built into our existing regulatory framework.
16 So I would urge you in a timely manner to move
17 along with what guidance you might come forward with for
18 your members because we are going to move along in terms of
19 what we have to do but we are not looking to put those
20 utilities that happen to own nuclear assets at a competitive
21 disadvantage relative to those that are not.
22 At the same time, we have a health and safety
23 responsibility. But I think it is a shared responsibility
24 that, in the end, you also have. Because the nuclear assets
25 in your states were built under certain presumptions about

1 cost recovery and the like. But, in the end, we have to do
2 what propagates into our regulatory regime.
3 Mr. Ellsworth?
4 MR. ELLSWORTH: Madam Chairman, if I can take off
5 my NARUC hat for a minute and put on my New Hampshire hat,
6 although we recognize your legal responsibility for health
7 and safety, I assure you that we have at the state level at
8 least a moral obligation because it was we who assisted or
9 participated in the bringing of those power plants on line
10 in the first place. So if there were health and safety
11 problems, it would be our reputations as much as yours if
12 there was a failure.
13 I can tell you in New Hampshire even in the
14 absence of the specific principles that we at NARUC are
15 working toward, that the state regulators have principles of
16 their own in mind to assure the decommissioning costs are
17 going to be covered. We have state laws to require that
18 decommissioning costs are identified and provided for. We,
19 in our restructuring orders, have made provisions to assure
20 that they are nonbypassable.
21 So even in the transition, states have those
22 issues very much in mind and have health and safety very
23 much at the forefront of those decisions.
24 CHAIRMAN JACKSON: Are any of you dealing with the
25 issues of where in the creditor queue decommissioning costs

1 should stand or where in the queue they should be relative
2 to bankruptcies in your states?
3 MR. GEE: That is a very good question. I will
4 give you as honest an answer as I can give you.
5 Ironically, it has not come up yet, even though we
6 have had a bankruptcy in our state of an electric utility
7 that had some nuclear generation. And the same, I know,
8 holds true with Commissioner Ellsworth.
9 You have before you two commissioners from the two
10 states where there have been major utility bankruptcies. I
11 don't recall, frankly, the question of exactly where the
12 priority of decommissioning funding falls within this
13 bankruptcy queue priority. I do know that the way the
14 restructured bankruptcy occurred in our state, it did set
15 out a list of priorities and I would have to go back and
16 check the record, and I can provide that information to you.
17 But I do know that while the bankruptcy was
18 pending and ultimately after it emerged from bankruptcy,
19 there was no immediate concern that the impaired financial
20 integrity of this particular company was going to harm the
21 continued and safe operation of the nuclear power plant. I
22 believe that it owned a fractional share of this plant.
23 CHAIRMAN JACKSON: Right. I think that's the
24 reason.
25 MR. GEE: Seventeen percent, I believe, of Palo

1 Verde was held by El Paso Electric.

2 MR. ELLSWORTH: In terms of collection of

3 decommissioning costs, my recollection, in our bankruptcy,

4 because we have a separate statute that requires the

5 collection of those costs that the bankruptcy did not affect

6 the collection of those costs.

7 CHAIRMAN JACKSON: Does --

8 MR. GEORGE: Commissioner Jackson?

9 CHAIRMAN JACKSON: Yes.

10 MR. GEORGE: If I might comment, Iowa does not

11 have a utility in trouble but I think that the priorities

12 that are set with regard to a bankruptcy are set by

13 Congress. States have some provision with regard to

14 personal effects that are protected from bankruptcy but the

15 state laws are all preempted.

16 CHAIRMAN JACKSON: Right.

17 Does NARUC endorse the concept of mandatory NERC

18 membership by whomever operates transmission facilities?

19 MR. GEE: We have not taken a position on that

20 specific matter. What we have said, and I think our

21 statement of principles does indicate and, in fact, it is

22 probably the one of the first principles there, is continued

23 reliability above all else must be maintained in a

24 restructured economic market.

25 We have been working very closely with our

1 utilities to ensure that no matter what economic decisions
2 we make with respect to opening up market opportunities to
3 new entrants, that the imperatives of reliability must
4 continue to be met and, to the extent that there is a cost
5 associated with maintaining that reliability, we will make
6 efforts to ensure that, if need be, those costs are commonly
7 borne and shared by all rather than simply subject to
8 recovery in a competitive market.
9 But, no, we have not officially taken a stance on
10 recommending mandated membership in NERC.
11 CHAIRMAN JACKSON: You mentioned with respect to
12 the ISO concept a good question is what is truly
13 independent. And you talked about how reliability would
14 mesh with the shift of control to, you know, an entity
15 without ownership.
16 Do you view the efforts going on in terms of the
17 Midwest ISO to be a potential model for how to address the
18 issue?
19 MR. GEE: I am not that familiar with that
20 particular ISO and the discussions that they have been
21 having other than what I generally read through the trade
22 press to be able to respond adequately to your question.
23 As I indicated, the concept of an ISO varies from
24 region to region and what we are seeing grow out of this
25 process is a variety of different approaches. I do know

1 that a common concern that I have heard is who is ultimately
2 responsible for making sure that the grid is maintained and
3 whether reliability is -- whether the grid ultimately
4 continues to have the same degree of reliability when you
5 try to divorce control and ownership.
6 CHAIRMAN JACKSON: Does it present the state
7 utility commissions with an inherent conflict of interest in
8 the sense that, you know, to truly have an independent
9 system operator may require some transference of regulatory
10 authority with respect to grid management, planning, et
11 cetera?
12 MR. GEE: I think that is a very good question. I
13 think, in fact, it does pose a question of to what extent
14 can a state commission or a state regulator have sufficient
15 jurisdiction to cover what is essentially a regional entity
16 that is making control and operations decision across the
17 grid. I do know that generally the FERC has been authority
18 that has asserted jurisdiction over the ISO approval process
19 so I would anticipate that there is some regulatory
20 oversight but I also know that individual states may also
21 have different imperatives in making sure that their segment
22 of the grid is maintained in an adequate fashion and that
23 reliable service continues to be provided and that states,
24 for example, have jurisdiction over the siting of new
25 transmission or additional transmission facilities. That is

1 a province that has traditionally been held within state
2 jurisdiction.
3 CHAIRMAN JACKSON: I accept that if you are
4 talking about regional grid management, there are issues
5 having to do with congestion?
6 MR. GEE: Yes.
7 CHAIRMAN JACKSON: Vulnerability of the grid that
8 plays in the large to planning, which may be beyond a given
9 state interest.
10 MR. GEE: I agree. And I think that the questions
11 that you raise point up the unfortunate infirmities of the
12 existing state/federal scheme that, in fact, the Federal
13 Power Act and the respective state statutes are not well
14 suited to what is essentially now becoming more and more a
15 regional market which is beyond the individual authority of
16 a state and certainly something which is going to have to be
17 balanced with a need for continued federal oversight.
18 CHAIRMAN JACKSON: What is the resolution of this
19 dichotomy?
20 MS. TOMASKY: There is -- you very accurately, I
21 think, describe a natural tension that occurs as we are
22 moving forward on a couple of different fronts. The first
23 really has to do with the tension between the desire for
24 separation for business purposes between generation and
25 transmission and when you get into the retail side

1 distribution, and the desire to make sure that the people
2 who are in charge actually are enough in charge that they
3 can make the decisions necessary to turn the lights on and
4 keep them on.
5 I think that we are going to be engaged, as ISO
6 proposals come before us, in a very nitty gritty debate that
7 will come to us in filings from people on all sides over
8 very specific issues about management and control of the
9 transmission systems and we will have to decide. Everybody
10 who has an interest in that is going to have to participate
11 and tell us.
12 We have already begun to see circumstances in
13 which marketers, independent sellers who are interested in
14 maximum separation will tell us that specific kinds of
15 decisionmaking need to be separated from the sellers. We
16 have also had utilities tell us that that is not going to
17 work.
18 From a reliability perspective, I think that our
19 Commission has tended to be, in the end, although we test
20 the assumptions and the claims of the utilities, I think in
21 the end we care most about reliability and so far we haven't
22 done anything, I don't think and I don't think we would be
23 inclined to make a specific decision that would impair that.
24 Although we would have a tendency to question claims, to be
25 sure that we are not facing a situation where someone claims

1 it is reliability and it's not.

2 You are absolutely right about the regional

3 planning issue and I know it is something our colleagues in

4 the states are dealing with. Our Commission at times in the

5 past has encouraged the formation of regional transmission

6 groups but we have been, I think, disappointed that RTGs

7 have not assumed a more prominent role in regional planning

8 because we do think that there are enormous efficiencies to

9 be gained in managing congestion and managing planning from

10 that perspective.

11 But it is a legitimate issue of concern for the

12 state, citing issues for state concerns. They involve a

13 host of environmental and power supply issues that states

14 have been traditionally in charge of.

15 I do know that folks at NARUC are talking about it

16 a lot and they understand it is a tension. It hasn't gotten

17 much play at this point in the congressional debate but I

18 think it is a very, very important and difficult issue.

19 CHAIRMAN JACKSON: Mr. Ellsworth?

20 MR. ELLSWORTH: Let me just offer my perspective

21 and it is a personal one and it is limited to NEPOOL and our

22 New England experience.

23 It is my personal opinion that no one can run the

24 transmission grid as well as the utility industry itself

25 can. It is my opinion that the value of the ISO is not

1 necessarily to run the system but it is to make sure that
2 the system is open to everybody and I think that is the
3 direction that we have gone.
4 There has been an opportunity in New England for
5 the regulatory community to participate in the organization
6 and establishment of the ISO to make sure that that
7 independence is maintained. The regulatory community has
8 opted, although it has been invited, not to be a part of the
9 ISO but to monitor it closely and be a close part of it, to
10 see that it is being done openly and properly. I think
11 that's the way it should be.
12 In terms of siting, New Hampshire has had a number
13 of siting issues before it and a number of the siting
14 projects that have been brought to the state's attention,
15 and we have a separate siting law that looks at each one, a
16 lot of those projects have not been for the sole purpose of
17 benefitting the state of New Hampshire. But our law
18 requires that we have the region in mind and each one of our
19 decisions has had that region in mind.
20 Having said that, though, I can tell you that our
21 state is not prepared to relinquish siting authority to
22 someone else beyond our control.
23 CHAIRMAN JACKSON: Commissioner Rogers?
24 COMMISSIONER ROGERS: I have no additional
25 questions.

1 CHAIRMAN JACKSON: Commissioner Dicus?

2 COMMISSIONER DICUS: No.

3 CHAIRMAN JACKSON: Commissioner Diaz?

4 Commissioner McGaffigan?

5 COMMISSIONER McGAFFIGAN: I do have two.

6 Given the importance of decommissioning costs, I

7 read through your NARUC principles and I couldn't find any

8 reference to it. I mean, stranded costs get mentioned

9 toward the end.

10 Are you going to consider reissuing the principles

11 at some point with some bolstered discussion of the

12 importance of taking care of decommissioning costs?

13 MR. GEE: I don't know if we would necessarily

14 amend our statement of principles. The statement of

15 principles was adopted almost a year ago before some of our

16 states and state legislatures began acting on

17 decommissioning.

18 COMMISSIONER McGAFFIGAN: Right.

19 MR. GEE: It does address, within the context of

20 the statement, the need for states to weigh the concerns of

21 stranded costs and to make sure that stranded costs are

22 addressed in a fair and equitable fashion. So we would --

23 just using the perspective of that language, we have

24 regarded that as broadly inclusive, to include the questions

25 occasioned by decommissioning cost recovery.

1 The separate question of how to recover
2 decommissioning costs and whether they are sufficient, I
3 think, is something that is going to be the subject of our
4 dialogue and what would happen out of that is if we can
5 reach a consensus within the national association to make a
6 recommendation to our member commissions, that would then be
7 reflected in a resolution that we would then take up by our
8 executive committee and would formally become a position of
9 the association which would have the strength of essentially
10 being a part of the statement of principles by virtue of a
11 second resolution.
12 So the short answer is the association will have
13 an opportunity to examine more specifically all of the host
14 of policy issues with respect to decommissioning cost
15 recovery and then take up through the form of a resolution a
16 position that would be given equal weight as though it were
17 part of the original statement of principles.
18 COMMISSIONER McGAFFIGAN: The other issue I just
19 want to clarify, tax code issues came up in the discussion
20 and is there any need in terms of in the decommissioning
21 cost area of looking at the interaction of how these costs
22 are recovered with the federal or state tax codes?
23 I am just trying to understand when plants are
24 prematurely retired, is Connecticut Yankee or Zion or
25 whatever have been or are going to be, was that foreseen in

1 the tax code and are there problems that come up in the tax
2 code that we haven't previously foreseen?
3 MR. GEORGE: I don't think it was anticipated in
4 the tax code and I think it will require attention in terms
5 of legislation. I think the reason it was raised at our
6 January meeting was to solicit support from NARUC in terms
7 of making the tax change.
8 Our response was that we should probably talk
9 about the entire issue of decommissioning in such that we
10 can respond not only to the tax issue but the other issues
11 that are associated with it.
12 COMMISSIONER McGAFFIGAN: Thank you.
13 CHAIRMAN JACKSON: Yes.
14 MS. TOMASKY: I did want to mention that we did
15 deal with this issue briefly but we somewhat directly in
16 Order 888, the question of deductibility of nuclear
17 decommissioning costs in particular and stranded costs was
18 raised before us and we were asked to clarify that if
19 someone is recovering stranded costs that that is part of
20 the utility's cost of service and it was suggested to us if
21 that were the case that that would help shore up continued
22 deductibility of those costs. Indeed, we did make that
23 clarification.
24 Now, I can't testify whether or not that is
25 sufficient for the IRS for those purposes but we did make

1 that clarification at the request of some utilities.

2 CHAIRMAN JACKSON: Thank you. Thank you very

3 much.

4 Let me call the industry panel and to thank them

5 in advance for their patience. I think the next time, if we

6 have another meeting on this subject, we will begin with the

7 industry panel.

8 Let me make a comment that I was going to make as

9 part of my closing remarks while the groups are changing.

10 That is particularly I am thinking of the various regulatory

11 entities, that I would ask you not to finesse or back away

12 from the issues related to decommissioning costs and grid

13 reliability and security from the point of view of the

14 public health and safety implications or figuring it into

15 and taking a more direct and proactive stance because we are

16 not going to back away from it.

17 So I would just like you to keep that in the back

18 of your mind.

19 Mr. Colvin, I thank you, and Mr. Draper,

20 Mr. Harris and Mr. Asselstine. And however you wish to

21 structure this. We're all ears.

22 MR. COLVIN: Madam Chairman, thank you and good

23 morning.

24 I would like to really begin with Dr. Draper's

25 presentation and followed by mine and work down in that

1 order, if that is acceptable?

2 CHAIRMAN JACKSON: Sure.

3 MR. COLVIN: Thank you.

4 DR. DRAPER: Good morning, Chairman. Thank you
5 for the opportunity to be here. Members of the Commission.
6 This is I guess the second time I have appeared on this
7 subject, the first being about 18 months ago at the first of
8 these sessions and we appreciate the chance to talk about
9 the important subjects.

10 In terms of regulatory actions, the starting point
11 is the NRC's action plan and initial draft of proposals to
12 position the NRC for the restructuring of the electric power
13 business. The draft policy statement, the advanced notice
14 of proposed rulemaking on decommissioning and the draft
15 standard review plans published last year raise some of
16 NRC's major concerns and allowed the industry to provide its
17 perspective on these important issues.

18 I am here today representing a cross-section of
19 the electric power industry. As a member of the NEI
20 executive committee and since last June as Chairman of the
21 Edison Electric Institute, I will address the electric
22 industry's policy objectives as restructuring proceeds and
23 outline the more specific goals and objectives established
24 by the nuclear power industry. Joe Colvin will then discuss
25 some of the more significant nuclear regulatory issues.

1 I think it is fair to say that the restructuring
2 of the electric power industry is proceeding more slowly at
3 the federal level and more quickly at the state level than
4 many people expected even a year ago. At the federal level,
5 I believe the 105th Congress and the Administration are
6 beginning to recognize that we must approach electricity
7 deregulation and restructuring carefully and deliberately
8 because the economic and social costs of mistakes would be
9 very high.
10 The national interest demands that we get it
11 right. We must ensure that all consumers of electricity,
12 large and small, will benefit from restructuring in terms of
13 cost, service and reliability. We must ensure that the
14 transition to competition recognizes past regulatory
15 commitments, providing for the opportunity for the recovery
16 of prudent, legitimate stranded commitments through the
17 Federal Energy Regulatory Commission and the states.
18 For policymakers, the first step is to establish
19 broad areas of responsibility, what decisions should be made
20 at the federal level, what authority should be reserved to
21 the states and what determination should be left to the
22 market.
23 We believe the federal government should
24 articulate general principles and guidance and address those
25 issues that only the federal government can address such as

1 possible amendments to the Atomic Energy Act, repeal of the
2 Public Utility Holding Company Act, the Public Utilities
3 Regulatory Policy Act, which are major impediments to
4 competition.
5 Recognizing that states have differing
6 circumstances, we continue to think that the majority of the
7 issues are best handled at the state level. We believe that
8 some issues, corporate structure, for example, should be
9 left to the market. Government-imposed divestiture, in
10 particular, we believe, would be inappropriate.
11 Turning to the state level, based on what we have
12 seen in states like California and Pennsylvania which have
13 significant nuclear capacity, we are generally encouraged by
14 the responsible manner in which state government officials,
15 regulators, legislators and governors are approaching
16 restructuring. We are particularly encouraged by the
17 explicit recognition in both California and Pennsylvania
18 that nuclear plant decommissioning is a public health and
19 safety imperative and decommissioning funding must be
20 assured.
21 We recognize that decommissioning funding
22 assurance is one of NRC's major concerns and rightly so. We
23 believe the NRC can and should take considerable comfort in
24 the way the states have handled this issue so far. Let me
25 assure you that the nuclear industry also regards

1 decommissioning as a national public health and safety
2 imperative and considers assurance of decommissioning
3 funding is one of our highest priorities.
4 Let me turn now to the nuclear industry's major
5 goal as restructuring proceeds and the objectives we have
6 formulated to the achievement of that goal.
7 The goal is very simple, to maintain the excellent
8 safety performance and ensure that nuclear plants are not
9 placed at a competitive disadvantage as restructuring of the
10 electric power industry proceeds. To reach these goals, the
11 industry has established four specific objectives. These
12 are not in any particular order; they are equally important
13 to us.
14 First, we must provide the industry with maximum
15 possible certainty and clarity about future nuclear
16 regulatory requirements as companies consider restructuring
17 options such as consolidation of nuclear operations,
18 ownership transfers and the like.
19 Second, we want to ensure that companies have
20 maximum possible flexibility to reposition their nuclear
21 generating assets without subjecting those nuclear units to
22 unnecessary economic penalties or financial stress.
23 Obviously, NRC regulations and requirements,
24 particularly in the area of financial assurances, will play
25 a major role here.

1 Third, in federal or state legislation, the
2 industry believes that nuclear utilities should have a
3 reasonable opportunity to recover stranded costs, including
4 unrecovered capital and unfunded decommissioning
5 obligations.
6 Finally, we believe it is appropriate to undertake
7 a critical examination of certain provisions of the Atomic
8 Energy Act, to determine whether the conditions that
9 justified those provisions still prevail. If conditions
10 have changed then we believe that the Atomic Energy Act
11 should be clarified or amended.
12 Joe will cover several specific nuclear regulatory
13 issues. NRC requirements and regulations are one of the
14 critical factors that will influence the nuclear industry's
15 business decisions going forward, including the degree of
16 flexibility available to licensees as they consider how best
17 to position their nuclear plants for a competitive
18 environment. One of the major tasks as we move forward will
19 be to define those issues in areas which involve nuclear
20 safety and are thus within NRC's purview and those critical
21 issues that fall outside NRC's statutory mandate.
22 Recovery of statutory commitments is a critical
23 issue that falls outside NRC's statutory mandate. Various
24 NRC officials have expressed concern recently about recovery
25 of those stranded commitments. Although recovery of

1 standard commitments is one of the industry's major issues
2 and although we would welcome NRC's support for the general
3 principle that companies should be allowed a reasonable
4 opportunity to recover prudent, legitimate and verifiable
5 stranded commitments, we don't believe recovery of stranded
6 commitments is a legitimate NRC safety issue.
7 Recovery of stranded commitments involves whether
8 or not a company will be able to meet its fiduciary
9 obligations to its shareholders and bondholders. It is
10 entirely separate from operating economics which will
11 determine whether or not a nuclear plant or any power plant
12 will continue to operate.
13 We believe the public interest is best served if
14 the NRC focuses on results, on answering the key question,
15 what are we trying to achieve. The answer, we would assume,
16 is to continue to ensure the adequate protection of public
17 health and safety.
18 So how do we separate the success path for this
19 objective? The NRC might have started this process by
20 articulating the issues on its mind regarding nuclear power
21 plants operating in a restructured competitive market. Now
22 the NRC must engage the industry in a substantive discussion
23 about whether or not those issues are important and then
24 develop practical mechanisms and techniques to address the
25 important issues.

1 Let me now turn the microphone over to Joe Colvin,
2 NEI's president and CEO, for the second half of our
3 presentation after which we will be happy to answer your
4 questions.
5 MR. COLVIN: Madam Chairman, commissioners, good
6 morning again.
7 As Linn indicated, I would like to spend a few
8 moments and talk about some of the specific aspects of the
9 Commission's interest related to restructuring that are
10 specific to the nuclear energy industry and that need the
11 Commission's attention.
12 The U.S. nuclear energy industry is a mature
13 industry and it is a natural evolution for it, as part of
14 the larger electricity industry, to move toward deregulation
15 and associated restructuring. Restructuring presents unique
16 challenges for the industry and for the agency that
17 regulates it, but it also presents opportunities for
18 positive change. It is forcing us to look at the most
19 efficient ways to meet our respective responsibilities.
20 Our number one goal, of course, is to maintain
21 excellence and safety performance while ensuring that
22 restructuring does not place nuclear power plants at a
23 competitive disadvantage and Linn outlined the industry's
24 four key objectives related to restructuring. I would like
25 to elaborate on those just a bit.

1 As he mentioned, one of the industry's objectives
2 is to ensure as much clarity and certainty as possible, in
3 particular concerning future regulatory requirements for
4 plant ownership, license transfer and related issues.
5 Another objective which is closely related is to ensure that
6 utilities have the flexibility to reposition their nuclear
7 generating assets without undue regulatory burdens.
8 The industry needs as much certainty as possible
9 in advance concerning what financial assurance and
10 requirements in that area will be necessary and acceptable
11 to the NRC to fulfill its safety responsibility.
12 This is essential to allow consolidation of
13 nuclear units into new operating entities, ownership
14 transfers and other restructuring arrangements. Regulatory
15 requirements must allow utilities the flexibility to make
16 the changes they deem best in order to compete. If they
17 cannot reposition their nuclear generating assets without
18 lengthy regulatory proceedings, nuclear energy will not be
19 able to compete with generating sources that are not
20 similarly burdened. In order to provide the clarity and
21 certainty, we believe changes are needed in the license
22 transfer process as well as how the atomic safety and
23 licensing board proceedings are conducted.
24 Any requested license amendment involving a change
25 in ownership or control of a commercial nuclear power plant

1 involves NRC reviews and likely, in most cases, will involve
2 a formal hearing. Certainly, the NRC and its licensing
3 boards must fully explore the important safety issues that
4 might be raised.
5 We believe changes are needed to ensure that the
6 existing process does not give competing factions an open-
7 ended opportunity to manipulate the NRC's regulatory process
8 to the disadvantage of the nuclear power plant operators and
9 owners and to the NRC's disadvantage as well. We believe
10 the Commission should provide direction to its licensing
11 boards to ensure that their inquiries are limited to issues
12 that arise within the context of the proposed license
13 amendment or transfer being sought. The boards should also
14 ensure that a clear safety basis exists for issues that
15 intervenors seek to raise in NRC proceedings.
16 The industry also believes it is time to reexamine
17 certain provisions of the Atomic Energy Act to ensure its
18 applicability to a mature industry. In particular, the
19 requirement for NRC to conduct antitrust reviews and the
20 current restrictions on foreign ownership of nuclear power
21 plants that have been discussed earlier today, in our view,
22 need to be eliminated. Antitrust and market power
23 considerations are already examined extensively in cases
24 involving mergers and acquisitions, transmission tariffs and
25 other corporate restructuring by the Federal Trade

1 Commission, the Department of Justice, the Securities and
2 Exchange Commission, the Federal Energy Regulatory
3 Commission and state regulatory commissions. The Act's
4 current restrictions on foreign ownership of nuclear power
5 plants represent an unnecessary impediment to responsible
6 foreign entities that are willing and eager to invest in
7 commercial U.S. facilities.
8 We believe the NRC should examine the Atomic
9 Energy Act and initiate legislation where appropriate to
10 amend the act. The industry will work with you to support
11 necessary legislative changes.
12 Another objective involves the recovery of
13 investment and, in particular, recovery of decommissioning
14 and stranded costs. While Linn thoroughly discussed this, I
15 would like to add that the industry continues to encourage
16 the NRC to support legislative or regulatory proposals that
17 would allow nuclear plants to recover decommissioning costs
18 and other prudently incurred costs that may become stranded
19 in transition to a competitive environment.
20 I have discussed several of the industry's
21 objectives related to restructuring. But the fundamental
22 issue important to restructuring is the regulatory process.
23 In scheduling these two days of briefings, the NRC invited
24 comments on how it can best address issues related to
25 restructuring.

1 I believe the agency would provide tremendous
2 value to its customer, the American public, by creating a
3 more efficient, safety-focus regulatory process. Regulatory
4 requirements must have a clear nexus to safety, the NRC's
5 statutory mandate and the industry's highest priority.
6 As I mentioned earlier, the U.S. nuclear industry
7 is a mature industry and is a benchmark for the rest of the
8 world's nuclear programs. Overall, U.S. nuclear power
9 plants are performing at very high levels of safety,
10 reliability and cost efficiency and the NRC has ample
11 regulatory mechanisms to address any safety issue that might
12 arise at any plant. Yet even top performing plants are
13 struggling today with a regulatory process that has become
14 excessive, a process that tends to regulate to the lowest
15 common denominator and that frequently extends, in our view,
16 beyond the agency's safety mandate.
17 In regulating the cost of service environment, the
18 cost of excessive NRC requirements is recovery with the
19 approval of the state regulators and, frankly, consumers
20 have paid for meeting requirements that in some cases do not
21 have a clear link to improving plant safety. In a
22 competitive market, NRC and the utilities must reexamine the
23 cost/benefit relationship of regulation more closely.
24 Today, the rules are changing. The industry and
25 the NRC have the responsibility and, in fact, the

1 opportunity as well to reexamine how nuclear power plants
2 are regulated. In a regulated industry, inefficient or
3 excessive regulation can place nuclear power plants at a
4 competitive disadvantage and the NRC's regulatory process
5 must be clearly defined and sharply focused on safety.
6 When it is not, it creates confusion and
7 misunderstanding for both the industry and the regulator
8 about what each other's respective responsibilities are.
9 This has a tremendous impact on how nuclear energy is viewed
10 by the Congress, policymakers, the public, the financial
11 community and it creates the economic uncertainties for
12 companies that own and operate these plants.
13 The top performing plants in the United States
14 today both in safety and operational performance are
15 typically the most cost efficient as well. They are
16 competitive today but, in light of the uncertainties in the
17 current regulatory process, even these utilities face
18 significant challenges and the risk of being placed at a
19 competitive disadvantage.
20 As I indicated earlier, I think restructuring
21 presents many challenges but it gives us a lot of
22 opportunities to ensure that we continue the economic and
23 environmental benefits of nuclear and they will continue to
24 be realized by our nation.
25 Thank you.

1 MR. HARRIS: Thank you, Madam Chairman. We are
2 pleased to be here this morning to present to you some of
3 PJM's perspective on some of the restructuring issues. We
4 think we do have a specific and unique perspective to be
5 able to do this.
6 PJM is the oldest tight power pool in the world.
7 We are also the largest and most sophisticated entity of its
8 kind in the world. Over the past two years, for example, we
9 have had 48 different countries come to visit PJM and we are
10 larger than most countries in the world trying to implement
11 these solutions.
12 Over four years ago, we became a separate company
13 that administered this power pool, separate and distinct
14 from the member companies, so we have crossed those
15 problems. On February 28 of this year, the FERC approved
16 operations in PJM for the nation's first bid-based energy
17 market. They also approved in operations for PJM the first
18 multiple company, multiple state regional transmission
19 tariff administered by a single entity and this is the first
20 of its kind in the world.
21 We also have, within Pennsylvania and New Jersey,
22 beginning this year, substantial pilot programs on retail
23 choice and these programs will be in place over the next
24 three years.
25 We also have effective right now a pure

1 independent board running PJM. One of the FERC mandates for
2 having an independent board was that you have expertise on
3 that board in the operations of the power grid. We are
4 pleased that two of our board members, one, Dr. Richard
5 Leahy, Dean of Engineering at Rensselaer Polytechnic, who is
6 a nuclear expert in his own right, and another one, Mr. Lynn
7 Eury, former executive vice president and chief operating
8 officer of Carolina Power and Light, is on our board and
9 brings us some special nuclear perspectives.
10 In operations of PJM, if you look at the total
11 number of units, there is only one other entity that
12 operates as many units as we do to maintain grid
13 reliability. But part of that is our history in knowing how
14 to deal with the complexities of separate operations with a
15 separate control center with multiple companies in multiple
16 states.
17 We have 13 nuclear facilities of over 13,000
18 megawatts that we have to deal with. One of the things that
19 we have, for example, in learning in practice of how to deal
20 with is the coordination between a central operator between
21 the local control center and the nuclear facility. We have
22 procedures and plans in practice that we rehearse on
23 emergency procedure drills, procedures in plans and practice
24 on emergency restoration that we coordinate.
25 One of our key committees in PJM, for example, is

1 a nuclear coordination committee that can consist of the
2 plant operators, plant managers from each of the nuclear
3 power plants, the operators of the local control centers and
4 my operations staff. They meet regularly on the nuclear
5 coordination issues involved in this kind of an environment.
6 As we began to go along and look at how we are
7 going to proceed to the future -- next slide, please -- one
8 of the things that the states had wanted to maintain was the
9 benefits of this kind of arrangement that has been enjoyed
10 by this region over the years. Just energy alone last year
11 was going to be $100 million savings for that year alone.
12 The states of Maryland, the states of New Jersey, have
13 looked at PJM in separate analysis and said the annual
14 savings of being able to operate over multiple states,
15 multiple jurisdictions, multiple companies as essentially a
16 dispatch entity has savings in excess of $1.2 billion a
17 year. As we move ahead, we want to be able to maintain this
18 kind of savings and yet be able to ensure that competition
19 takes place in a robust way, which is national policy.
20 Next slide, please.
21 In looking at the power grid, what I wish to draw
22 to your attention here is the real interest, if you look at
23 the daily load shape, which I put up here for a typical
24 winter for PJM is, one, the size. Our minimum load of
25 26,000 megawatts is larger than the peak of every other

1 entity in the world except for eight. We will ramp, which
2 is the way that you move each hour, often over 4,000
3 megawatts an hour, which is larger than 115 other control
4 areas in North America.
5 In operations of this power grid, however, we have
6 to pay attention as to what's happening instantaneously. In
7 looking at it from that perspective is why we would suggest
8 to you that there are four cornerstones to look at,
9 cornerstones you may think are kin to a SALP report on power
10 grid operations, based on our experience.
11 Quite simply, we are flying an airplane that never
12 lands and you just can't stand still, the power grid, to
13 solve the problems of restructuring.
14 If you look at what takes place in restructuring,
15 you have a central operator, as I mentioned, where a
16 separate and distinct entity that operates an energy market
17 and a regional transmission tariff and the control area for
18 this grid. We are not technically an ISO at this point.
19 All the government structures are still being debated among
20 the participants. But as transmission is separated from the
21 load entities, as you get into retail choice and generation
22 becomes fully competitive, there are certain things that
23 have to be maintained in that functionality.
24 As you look at the different functionality and you
25 look at what is transpiring 24 hours a day, seven days a

1 week, it is a daunting task. For example, every three-and-
2 a-half seconds we have dispatch signals sent back and forth
3 between all the generation plants and our control center.
4 Every 10 seconds, we share over 500 data points from the
5 control areas around us and as far away as Canada to make
6 sure the integrity and security of the power grid of the
7 Northeast is in place.
8 Every 14 seconds, we have nearly 10,000
9 telemetered values sent in across the system that we look at
10 to maintain the status, to make sure the system is still
11 secure. Every 30 seconds, we have over 800 flows analyzed
12 on a full load flow that are checked against their limits on
13 the system to see if they are still in place.
14 Every 10 minutes, we have thermal contingencies
15 analyzed for nearly 1,200 points on the system to make sure
16 they are still in place and within their limits. Every 10
17 minutes we analyze the 300 worst voltage conditions on the
18 system and we take the top 15 expected contingencies and do
19 full load flows on those and that takes place every 30-
20 minute interval, 24 hours a day, seven days a week.
21 So if you look at it from this unique perspective
22 of a fully functioning and operating central operator over
23 multiple states, multiple districts and a very large entity,
24 we think that there are four cornerstones to look at as you
25 evaluate restructuring, whether it is occurring in this

1 country or the other countries that came by and worked with
2 PJM.
3 The first of these is you have to look at the
4 capability to reliably operate the grid. We can do that now
5 but the capability is extended because you have to have
6 capability to reliably operate the grid in a rapidly
7 changing environment. What the environment is going to be
8 next year when you get into full competition is going to be
9 different two years from now so your capability to operate
10 in the context of that is a must, as you restructure.
11 The second thing is information exchange.
12 Information exchange is critical. There is an interesting
13 article in the Electricity Journal this week talking about
14 how information exchange may be the Achilles heel as people
15 take self-interest and protective interest on the
16 information. Information is our lifeline. Without all the
17 information necessary, we can't operate the grid reliably.
18 Authority. You have to have authority to maintain
19 steps to maintain security of the system and it needs to be
20 clear and it needs to be stated. Within PJM, for example,
21 each local control center has clearly stated authorities and
22 what they need to do to protect the integrity of their
23 system on a local basis, including their nuclear facilities.
24 That is directly coordinated with the authority that my
25 dispatchers have in order to operate and be able to shed

1 load within the system.

2 In the new operating agreement we are operating in
3 right now, the president, myself, has clear authorities to
4 direct an emergency, declare an emergency and direct all
5 actions of entities out of that emergency. It is very
6 important that those authorities are clearly stated and
7 carried out when you have emergency conditions.

8 And, finally, if all of these things are met, the
9 important thing is that as you go forward, you have
10 predictable behaviors. Without having predictable behaviors
11 that you can make sure that you are going to have in the
12 grid, then you will have problems and you will have faults.
13 All of these are building blocks to ensure that that will
14 take place.

15 If we look at the first one, capability to
16 reliably operate the grid, I can't under stress the
17 importance of this in training. In PJM, we have five
18 percent of our budget in training. We train all the system
19 operators throughout the grid.

20 In starting up the bid-based energy market and the
21 regional transmission tariff that FERC approved for us on
22 February 28, from that time to date we have trained over
23 1,000 people. Over 400 operators have been trained and over
24 600 market participants. We have conducted training classes
25 throughout the mid-Atlantic region, we have conducted

1 training classes in Houston, Texas, for the marketers down
2 there on how to participate in this market.
3 I can't underscore the value of having
4 comprehensive training programs. NERC is very concerned
5 about this also and, as you probably heard yesterday, they
6 were talking about certification of training programs,
7 certification of operators and so forth. We support all of
8 these and think they are a must.
9 It is sl important that you have all of the
10 communications telemetering and so forth in place. For PJM,
11 this stuff is already in place.
12 In other areas, as they develop into the various
13 functionalities, like in California, they have many elegant
14 consultants and firms that are ensuring that whatever
15 processes and procedures come in place, the hardware and the
16 software and so forth will work. Again, you are flying an
17 airplane that can't land. You can't stand it down so the
18 systems have to be in place and have to work as they change
19 and as they go forth.
20 The emergency procedure drills are extremely
21 important, particularly as new players come in and come out.
22 PJM conducted an exhaustive emergency procedure bill before
23 we began our bid-based market and regional tariff that
24 involved not only the states but Department of Energy and
25 also involved the market participants to make sure that

1 should something have happened after we began our new energy
2 market that everyone was qualified and understood what would
3 take place during the emergency procedures.
4 Twice a year, we also conduct system restoration
5 after a blackout. We simulate a blackout of the entire East
6 Coast and go through restoration procedures that are heavily
7 involved. It takes about two days to go through the drills
8 but we found them exceedingly productive.
9 Madam Chairman, we would certainly welcome any of
10 this Commission or the staff to come by and observe our
11 drills and procedures as we go forward.
12 Information, as mentioned, you know, may be the
13 Achilles heel. As market participants begin to do their
14 thing and as generation becomes unbundled, it has to be
15 crystal clear and understood in whatever form that the
16 information to the grid operator has all the information
17 they need in order to operate the grid reliably. There is
18 many elements of these but I just want to highlight three
19 that would have to be put into the proper context of
20 whatever restructuring takes place in whatever portion of
21 the country or the world.
22 One is there is certain before-the-fact
23 information. In order to get the grid in a position to
24 operate reliably, you have to have data and information on
25 what is transpiring, what is taking place and so forth so

1 you can plan for the next day and up to the next week's
2 events. As we learned in January of '94, fuel levels, for
3 example, are very important, as we begun to run out of fuel
4 in January of '94 and the emergencies we had there.
5 Sometimes we wonder, when we get into a full
6 generation market, that could be extremely market sensitive
7 to know what the fuel levels are. Well, those are elements
8 we feel have to have contractual rights to make sure we have
9 all that information before the fact so we can make sure the
10 grid is positioned reliably.
11 You have transactions, as I elucidated earlier,
12 real time transactions of things you have to do as you
13 operate the grid hour by hour, day by day. And then you
14 have after-the-fact. You have to have all the information
15 necessary to analyze reliably and productively a fault
16 should it occur to determine what are the lessons learned.
17 And, as your industry knows very well, root cause analysis
18 is the key to be able to go forward and learn from mistakes
19 that will be made and to do this you must have exhaustive
20 amounts of data.
21 We have found in PJM our historical database right
22 now is in the terabytes and growing on the amount that we
23 have to capture and keep in stored level and I think the
24 ability for a central entity to be able to capture that,
25 store it, have it available for others to look at and so

1 forth is critical to the success.

2 This next slide on ISO functions, a little bit

3 busy and I won't go into that. But, again, we would

4 certainly welcome you to come and tour the center and we

5 will spend more time on this. But I just wanted to point

6 out, this is the operations that take place on the floor.

7 And you will see up at the top two separate networks. We

8 are in place, operating today with a bifurcated information

9 system where we have information that goes on what is termed

10 the OASIS for all the market participants. And, since we

11 operate both, the pool in and of itself does not participate

12 in the market; we strictly administer the market and make

13 sure it is operated according to the rules.

14 We have a separate information network that

15 concerns all of the security data. And I think as this

16 thing gets into place and works throughout North America

17 that we will be able to solve those information requirements

18 so we can operate the grid reliably. Confidentiality

19 agreements have been stressed and other sorts of things are

20 being put in place to ensure that this kind of

21 communications can continue.

22 The third element has to do with clear authority.

23 I had mentioned authorities that we currently have in PJM

24 but authorities must be tied to the developing role of

25 sanctions. One of my worst nightmares is that even though

1 you might have sanctions with penalties on the sanctions, a
2 party could take a commercial position that the penalty or
3 the sanction is just a cost of doing business and when you
4 are dealing with a real time system where you have to
5 make -- where you have a product that is instantaneously
6 generated and consumed, you can't have someone making a
7 commercial interest when you need that plant on or off or
8 whatever condition it may be.
9 So second guessing and self help is something that
10 could obviate the authority. So as these sanctions are
11 developed and put in place throughout North America and are
12 looked at for what the requirements are for various entities
13 to comply with those, could be the one that will make sure
14 the authority is clear and crisp or the one that could
15 undermine it.
16 Finally, we deal, have to deal with predictable
17 behaviors. We think that as the restructuring is taking
18 place through various places throughout this country and the
19 world, everyone is very concerned with reliability. I have
20 not come across one individual from the most avid marketer
21 to the most conservative that is not saying that reliability
22 must stay in place. Everyone recognizes the severe impacts
23 of an outage and, certainly, in this region for PJM that
24 serves arguably the world's political capital and in our hip
25 pocket has a city that on any given day can have 12 million

1 people in 10 square miles, you know that we have to have
2 reliability for this area. It is extremely important and
3 everyone is very sensitive to that.
4 But these four cornerstones, we feel, are what
5 needs to be developed and, as you look at the various
6 restructuring options, you need to ensure that the
7 capability is there and there are ways to measure the
8 capability through training, experience and so forth, to
9 make sure that takes place, certification.
10 Information is necessary and that comes through
11 the contracts that you have. The authority is there, which
12 is clear and crisp through the sanctions, the mandatory
13 rules and guides and so forth that have to be in place.
14 And, finally, with all of these together, we feel
15 that it can be a vibrant and a healthy new industry as it
16 moves forward and will meet the terms and conditions of
17 reliability that we all expect.
18 Thank you, Madam Chairman.
19 CHAIRMAN JACKSON: Thank you very much.
20 Rather than addressing specific questions at this
21 point, I am going to let Mr. Asselstine make his
22 presentation and then we can have a discussion.
23 MR. ASSELSTINE: Thanks, Chairman Jackson.
24 What I would like to do this morning and in the
25 next few minutes is just touch on a few topics that I

1 addressed before the NARUC meeting when I was on a panel
2 with Commissioner Rogers and I thought I would touch briefly
3 on some of the changes that we have seen as the competitive
4 framework is developing both at the federal level and at the
5 state level, talk about stranded cost recovery and
6 securitization which we view as a useful concept or tool
7 that can assist the utilities in recovering their stranded
8 costs, offer a few comments on disaggregation and then close
9 with just a few points on the effects of competition on the
10 operation of nuclear plants in the country.
11 If I could have my first slide, please?
12 At the federal level, there are a number of
13 legislative initiatives that are either being considered or
14 potentially could be considered over the course of this year
15 and next year. Certainly the industry has strongly
16 advocated repeal or modification of the Public Utility
17 Holding Company Act and also some of PURPA requirements that
18 utilities purchase power from independent power producers.
19 As you have heard already today, nuclear
20 decommissioning cost recovery is certainly a potential
21 candidate for legislation at the federal level and, finally,
22 there are a series of broader industry restructuring
23 proposals that have been introduced both in the Senate and
24 in the House that cover a fairly broad range, including
25 legislative proposals that would provide more of a one-

1 size-fits-all federal solution for retail competition and
2 stranded cost recovery to other proposals that would be more
3 of a safety net to help ensure the states all reach the same
4 ultimate objective in terms of retail competition.
5 If I could have my next slide, please?
6 As you have heard, there has been a very
7 substantial amount of activity at the state level. We
8 expect that trend to continue over the course of this year
9 and on into next year. By around the end of this year we
10 expect that many, if not most of the higher cost states in
11 the country, will have instituted industry restructuring
12 plans and proposals and we are also seeing, although we are
13 at a relatively earlier stage in the process, a growing
14 convergence among many of those state plans to include the
15 points that I have outlined here.
16 First, a reasonable transition period of on the
17 order of five years to get to full retail competition.
18 Second, the opportunity, although clearly not a guarantee,
19 for stranded cost recovery. Third, the phase-in of retail
20 competition over the transition period. Fourth, in many
21 instances the institution of a wholesale competitive market
22 to try to capture some of the incremental efficiencies and
23 cost savings from competition as we are working through the
24 transition period. The use of independent system operators
25 and I think you have heard a fair amount of that yesterday

1 and today. And, finally, in a number of states, the use of
2 securitized financing as a tool to accelerate competition
3 transition charge recovery.
4 If I could have my next slide, please?
5 We have listed here a number of states where we
6 expect to see activity. We have seen two states thus far
7 that have enacted comprehensive statutory frameworks for
8 industry restructuring. Those are California and
9 Pennsylvania. A number of other states are actively engaged
10 in the process and, with few possible exceptions, our
11 expectation is at this point that those frameworks will be
12 balanced and reasonable.
13 If I could have my next slide, please?
14 I have summarized a few of the key points from the
15 California statute. We do view the California legislation
16 as a fairly significant milestone in the transition to a
17 more competitive environment in the utility industry in the
18 country and we expect that it will continue to serve as a
19 model for state consideration in a number of other states.
20 I am not going to go through all of the elements in the
21 California statute.
22 A few that I would point to, first, the phase-in
23 of direct access or retail competition subject to the
24 implementation of a nonbypassable competition transition
25 charge that would be paid by distribution customers.

1 If I could have the next slide, please?

2 Second, and a trend that we are seeing among a
3 number of other states, emphasis on some near-term rate
4 reductions to provide some tangible benefits in many
5 instances, particularly for small customers, at the outset
6 of the process so that customers will see some near-term
7 benefits from the competitive marketplace and, finally, the
8 use of securitized financing as a mechanism to accelerate at
9 least a portion of the recovery of stranded costs by the
10 California utilities.

11 If I could have the next slide, please?

12 On stranded cost recovery, there are just a few
13 points that I would make. First, in terms of the magnitude
14 of the problem and the role that nuclear power plays in the
15 problem, there are basically three sources of stranded
16 costs. Those are, first, investment in above-market
17 generation, and that is really a sunk cost recovery
18 question. Second, above-market power purchase obligations,
19 which is really an ongoing operating expense for the
20 utilities. And, third, deferrals, regulatory assets and
21 funding of social programs such as demand-side management.

22 There are a variety of estimates of the magnitude
23 of the problem. Moody's Investor Service has put out a
24 recent update of their -- in 1996 of their estimate and they
25 continue to believe that the total amount of stranded costs

1 for the industry are about $136 billion.

2 A few other factors pointed out by Moody's, and I

3 think you have heard a bit of this already. Stranded costs

4 tend to be concentrated by region. The Northeast, the West

5 and portions of the Midwest are the regions that have the

6 largest concentration of stranded costs. Also the greatest

7 exposure in general is with the lower rated companies and

8 that is also not surprising since those were the companies

9 that had large plant construction programs under way in the

10 1980s.

11 A few key points in terms of stranded costs.

12 First, not all stranded costs are for utility-owned

13 generation. There are very substantial exposures to

14 stranded costs for power purchase obligations and we see

15 this probably most clearly in California and in New York.

16 Second, not all generation related stranded costs

17 are nuclear. There are some expensive coal units around

18 that were built in the '80s and those are a portion of the

19 stranded cost problem as well.

20 But, third, I think it is fair to say that nuclear

21 units and, particularly, many of the large current

22 generation units that were licensed in the 1980s do

23 represent a substantial component of the problem.

24 When we look at stranded cost recovery, and

25 actually if you could go back one slide, I think, great --

1 when we look at stranded cost recovery, we see it really as
2 a function of three components. The first of those is where
3 are the utility's rates today and where will those rates be
4 during the course of the transition period as you move to
5 full retail competition?
6 Second, if you use securitization as a tool for
7 stranded cost recovery, what benefits can you derive from
8 securitization?
9 And, finally, what a lot of regulators are
10 referring to these days as mitigation savings. What other
11 cost reduction savings can you wring out of the business?
12 Those are really the three components.
13 If I could move to the next slide, please?
14 This chart really just shows the revenue path for
15 California for the California statute. I think the
16 significance here is simply to point out that there are some
17 immediate cost savings that can be achieved in California
18 and we expect will be achieved through the use of
19 securitized financing. Those cost savings will cover most
20 but probably not all of the 10 percent rate reduction that
21 was mandated for small customers in California to begin on
22 January 1, 1998.
23 Over the course of the five-year transition
24 period, the continued benefits from securitization as well
25 as some of the other cost savings that the California

1 companies will achieve really provide the mechanism for
2 recovering a substantial portion of their stranded costs and
3 most stranded costs really are expected to be recovered by
4 the end of the transition period. With few exceptions,
5 unrecovered stranded costs at that point would become the
6 obligation or liability of the shareholders.
7 There is one significant benefit in California
8 that is a big plus for the California utilities. That is,
9 the structure of their independent power contracts. Those
10 contracts move to a substantially lower cost over the next
11 couple of years. By keeping rates at current levels or 10
12 percent lower for small customers, the utilities will be
13 able to keep those savings and apply them to stranded cost
14 recovery. Unfortunately, that is not a financial benefit
15 that exists in any other part of the country.
16 If I could have the next slide, please?
17 In terms of securitization itself, let me start
18 with just a brief description of what it is. It is really
19 the use of an asset-backed financing which is a nonrecourse
20 financing to the utility. Therefore, not a direct
21 obligation of the utility. This financing would have very
22 high credit quality, AAA credit ratings and that credit
23 quality would be derived from a statutory authorization to
24 impose an irrevocable and nonbypassable charge on the
25 utility's distribution customers which would then be used to

1 repay the debt. These bonds would not be obligations of the
2 state or obligations of the utility but would really be
3 backed by that statutory ability to collect revenues.
4 The utility would transfer their stranded costs
5 for securitization to a trust which would issue the bonds
6 and the utility would receive the cash proceeds from the
7 sale of the bonds. Those cash proceeds would then be used
8 by the utility to reduce their costs, typically by retiring
9 their existing debt and also by repurchasing some of their
10 existing common equity.
11 When we look at securitization, we really see six
12 benefits from it for the utilities and for their ratepayers.
13 The first of those is you can accelerate stranded cost
14 recovery and, effectively for the portion that is
15 securitized, you immediately recover those stranded costs.
16 The second and related benefit is that the utility
17 no longer bears any risk or uncertainty in terms of stranded
18 cost recovery for the portion that is securitized.
19 Third, the securitization permits the financing of
20 at least some stranded costs over a longer time period than
21 otherwise might be permitted. In California, for example,
22 securitized financings are likely to be over 10 years. The
23 normal period for stranded cost recovery is five. So it
24 gives the utilities the ability to extend out stranded cost
25 recovery over a longer period of time for at least a portion

1 of those costs.

2 Fourth, there are economic savings that can be
3 provided and translated into rate reductions. Those rate
4 reductions really help, I think, allow the states arrive at
5 a reasonable transition period for competition. Those
6 savings are really as a result of shrinking the utility's
7 capital structure. In effect, what the utility is doing is
8 taking assets that are currently on their books, financed
9 roughly half with equity and half with debt, refinancing
10 those very efficiently with 100 percent debt financing using
11 the guarantee of recovery of the revenues.

12 Finally, there should be benefits to the utility
13 through recovering their stranded costs in terms of
14 enhancing their credit quality by removing the uncertainty
15 for stranded cost recovery.

16 If I could have the next slide, please?

17 Just a moment on disaggregation and I think, at
18 that point, I probably will stop given the lateness of the
19 hour.

20 There are a variety of stages in terms of changes
21 that will take place in the organizational structure within
22 the industry. Most utilities have already established
23 strategic business units and the states are moving rapidly
24 to unbundle rates and separate rates out for the different
25 categories of the business.

1 As we move forward with competition, it is likely
2 that utilities will either separate their businesses into
3 separate subsidiaries within a holding company structure or,
4 ultimately, potentially sell or spin off some of their
5 assets.
6 If I could have the next slide, please?
7 In terms of spinoff of the assets, we tend to
8 think that most utilities would continue to prefer either
9 functional unbundling or structured unbundling within a
10 holding company system. Nevertheless, market power concerns
11 are likely to drive utilities more toward disaggregation
12 and, ultimately, utilities may agree to sell or spin off
13 assets in order to achieve unregulated status for their
14 generation. We see a number of examples of this at this
15 point both in California, in New England and also in New
16 York with Niagara Mohawk.
17 I think with that, I am going to stop at this
18 stage and turn it back over to you, Chairman Jackson.
19 CHAIRMAN JACKSON: Thank you very much.
20 In fact, I will begin with a comment and then a
21 question to you, Mr. Asselstine.
22 As you are aware, the NRC does not see its role as
23 directing how the amount or components of stranded costs are
24 to be defined or recovered. In fact, we will stop talking
25 about it and spend our time talking about decommissioning

1 funding since that is our issue.

2 But it is essential that we fully understand what
3 decisions are being made in establishing those definitions
4 and how they impact the availability of resources both for
5 operation but especially for decommissioning of nuclear
6 power plants. And the concept of securitization as you have
7 outlined it rests on an economic regulatory structure that
8 ensures a stream of revenue from ratepayers.

9 Can you -- you focused a lot on California but can
10 you extract from what you said two or three key issues you
11 think have to be clearly addressed, either in state
12 legislatures, by state legislatures or orders from PUCs or
13 others so that the revenue streams are, in fact, assured
14 that would back this approach?

15 MR. ASSELSTINE: Sure.

16 There are a few key ingredients that are really
17 necessary and I think our belief and this is true I think
18 for most of the firms that are involved in the asset-backed
19 financing business, is that you really do need, in order to
20 obtain the highest credit quality rating for these bonds,
21 AAA ratings, you really are going to need the statutory
22 underpinning to support these transactions.

23 The key legislative components that we are looking
24 for is the statutory creation of the ability to recover
25 stranded costs. Second, the authorization to impose a

1 nonbypassable and irrevocable charge so that once the bonds
2 are issued, you really know that the revenues will be there
3 until the debt is fully repaid. Third, what is called a
4 true-up mechanism and that is a tool to ensure that as you
5 move through the term of the debt, you have the ongoing
6 ability to adjust the size of the charge to make sure that
7 you continue to collect enough money so that all of the debt
8 is repaid. And a final provision is really a state covenant
9 that the state will agree both at the legislative level and
10 at the regulatory level not to do anything to disrupt or
11 impair the revenue stream that would be used to recover the
12 cost of this financing.
13 Those are really the core elements. At the
14 legislative level, there are also a corollary set of
15 requirements that we would look for in terms of the
16 individual state commission orders that implement the
17 legislation which basically track the same components.
18 If you have those elements, institutional
19 investors who invest in the asset-backed market would look
20 at this as a very stable and dependable asset class and they
21 would be willing to invest in these securities in the
22 amounts that are likely to be available. And as we look out
23 over the next say three or four years, we see a potential
24 size for this market of on the order of $50- to $100
25 billion.

1 CHAIRMAN JACKSON: You talked about the
2 establishment of a trust. Can you elaborate a little bit
3 more on the role that a trust plays in this financing
4 approach and, in your opinion, having been an NRC
5 commissioner, is this a critical factor in ensuring that
6 funds, particularly for decommissioning, would be available
7 when they are needed?
8 MR. ASSELSTINE: In terms of the asset-backed
9 financing, the trust is really a special entity, it is a
10 special purpose vehicle which only exists to receive the
11 transition cost asset and to issue the debt and then collect
12 the money and repay the debt. The objective here is to
13 ensure that it is bankruptcy remote, that nothing can be
14 done to impair the availability or access of those funds.
15 On decommissioning costs, I think the point that I
16 would make, I am actually quite encouraged. We are at an
17 early stage in developing the competitive frameworks through
18 many of the states but I am encouraged so far that state
19 regulators and legislators have really recognized that
20 decommissioning is a safety issue, it is an obligation and a
21 requirement that has to be met and there has been a pretty
22 clear willingness to impose the same kind of nonbypassable
23 and irrevocable charge to be paid by distribution customers
24 to meet ongoing decommissioning funding obligations over the
25 remaining operating life of the plant.

1 We have seen that in the statute in California, we
2 have seen the statutory authorization to the Pennsylvania
3 commission to deal with it and, although the Pennsylvania
4 commission hasn't acted at this point, I would expect that
5 they would follow the same path as in California and
6 recognize that this cost should be recovered along the same
7 lines as any other stranded cost. Perhaps this is a
8 separate item.
9 As long as the states continue to do that, that
10 ought to provide a fair amount of comfort to all of us, both
11 investors and to the Commission, that the decommissioning
12 funding requirements will continue to be met even if the
13 structure of the industry changes.
14 CHAIRMAN JACKSON: Can you just speak for a moment
15 in terms of what the financial impact you think would be,
16 the relative financial impact of the spinoff or sale of
17 assets as compared to a holding company?
18 MR. ASSELSTINE: That is a very interesting
19 question and I think all of us, both the utilities, those of
20 us who follow utilities from the financial side, the rating
21 agencies, are beginning to struggle with how do you evaluate
22 the individual pieces of the business as the utilities
23 restructure themselves. The next four or five years are
24 going to be a fairly interesting time in this industry and I
25 think, literally, you are going to see the shape of many

1 utilities change fairly significantly.

2 We have started to look at the individual

3 components. If you take the average vertically integrated

4 U.S. electric utility which has a single A credit quality

5 today, what you tend to see is a capital structure that is

6 roughly 50 percent equity, 50 percent debt, which reflects a

7 blended business risk position for that consolidated entity.

8 We tend to believe and our informal conversations with the

9 rating agencies tend to confirm that if you looked at the

10 distribution part of the business, the risk profile of that

11 business is probably lower than the vertically integrated

12 utility. It will continue to be a regulated monopoly. In

13 all likelihood we are going to see performance-based

14 ratemaking for that part of the business. So utilities will

15 have an incentive to lower their costs, they will be allowed

16 to keep at least a portion of any economic savings that they

17 are able to achieve.

18 Given the lower business risk profile of the

19 distribution business, it ought to be possible to maintain

20 single A credit quality by increasing leverage, for example,

21 to say a debt-to-total-capitalization ratio of on the order

22 of 60 percent rather than 50 percent. You can also probably

23 operate that business with lower cash flow coverages or

24 earnings coverages for your interest requirements than you

25 would normally see for a vertically integrated utility.

1 I think generation is the flip side of the coin.
2 The generation business is likely to be a competitive
3 market-priced business. If stranded cost recovery goes as
4 we expect it to, at the end of the transition period we
5 should have most of the generation assets marked either at
6 market or very close to the market price that those assets
7 need to have to be able to compete effectively in the
8 marketplace. But it will be a competitive market, your
9 revenues will depend upon your ability to sell power at
10 competitive prices and therefore that business probably has
11 a higher risk profile.
12 Our rough cut there is that you probably won't be
13 able to leverage that business as much as the vertically
14 integrated utility. Perhaps the right capitalization is a
15 40 percent debt to total cap of larger equity component for
16 that business and you may need higher cash coverages of
17 interest along the lines of other commodity-based kinds of
18 industries in the country.
19 If you begin to parse out nonnuclear and nuclear
20 generation, I think that the equation shifts even more
21 dramatically as you look to the nuclear units. Again, if we
22 get through stranded cost recovery, what you really are
23 focusing on in the nuclear units is an avoided cost issue,
24 how competitively can those plants operate, and I agree with
25 the comments that Linn and Joe made.

1 Well run, larger nuclear units in this country
2 should be able to compete very effectively. If you look at
3 the top quartile performers in the industry, those plants
4 can generate power taking into account fuel and O&M costs of
5 well below 2 cents per kilowatt hour. That is a very
6 competitive price, in my view, given where the market is
7 likely to be in virtually any part of the country.
8 If you go down the performance scale and look at
9 plants in the lower quartile of the industry, I think there
10 may be a different story there and my suspicion is those
11 plants are really going to have to move up more toward the
12 mid range or the higher portion of the industry if they are
13 going to be able to compete effectively on a long-term
14 basis.
15 You also have problems with smaller, single-unit
16 sites like a Connecticut Yankee where I think even if it is
17 basically a sound plant, the economics may weigh against the
18 plant on a variable cost basis.
19 CHAIRMAN JACKSON: Well, one thing that seems to
20 come out of what you are saying, though, is the question of
21 who or what kind of entity securitizes the stranded costs in
22 the sense that since you are basically talking debt
23 financing here, this whole issue of cash, higher or lower
24 cash covenants is part of -- coverages, rather, as part of
25 some kind of covenants could be harder to securitize that

1 debt could be impacted, you are basically saying, by the
2 structure of the company?
3 MR. ASSELSTINE: Well, I think as long as you have
4 the statutory provisions you can deal with the stranded cost
5 problem regardless of the organizational structure of the
6 company. Where the organizational structure will really
7 come into play, I think, is on an ongoing basis what
8 financial capabilities will the company really need to
9 compete effectively and how do you factor that in also on
10 the generation side in terms of where they are going to have
11 to be able to produce power to be competitive with other
12 sources.
13 CHAIRMAN JACKSON: Okay, thank you.
14 I just have a quick question for Mr. Harris. In
15 your discussion of restoration procedures, you have specific
16 protocols with respect to nuclear plants.
17 MR. HARRIS: Yes, ma'am, we do.
18 CHAIRMAN JACKSON: Could you just give a few words
19 to say something about that?
20 MR. HARRIS: Well, we have the protocols embodied
21 in our operating procedures in accordance with the NERC
22 protocols and guidelines. They have a high priority for
23 restoration.
24 CHAIRMAN JACKSON: Okay.
25 MR. HARRIS: In our emergency restoration where we

1 black out the grid, one of the things we look at is how
2 quickly can the units come back on. One of the things that
3 we are looking at and having discussions, for example, is if
4 you assume a total blackout how quickly, in an emergency
5 condition, can you get the plants back on line.
6 That hasn't been totally solved but, for PJM, for
7 example, in our drills, assuming they can come back readily
8 will make the difference in having the grid back on line
9 within 24 hours as opposed to five days. So this is
10 something that is continually looked at as we do these
11 drills and rehearsals. It is very important to us.
12 CHAIRMAN JACKSON: You talked about before the
13 fact, real time and after the fact communication and you
14 spoke about intra and interregional communication from an
15 after-the-fact point of view. Are there key elements from a
16 before-the-fact point of view in terms of interregional
17 communication as far as the interface with other regional
18 grids and issues of degradation of voltage on the grids?
19 Are there some operating or governing protocols in that
20 area?
21 MR. HARRIS: Yes, ma'am. In the NEPOOL, PJM, New
22 York Power Pool, Ontario Hydro, Hydro Quebec area, we have
23 protocols for us, Allegheny Power System and Virginia Power.
24 For years we have shared data. We have over 500 data points
25 that we share every 30 seconds that we share amongst

1 ourselves automatically that is folded into the analysis
2 that we do on the power grid. It is a very robust and
3 probably the most robust sharing of data in and amongst the
4 region in the whole of North America.
5 CHAIRMAN JACKSON: Do you see any of that as being
6 unnecessarily threatened by any of the competitive
7 pressures?
8 MR. HARRIS: No, ma'am, I do not. I see it being
9 enhanced, actually, with the advent of security centers
10 which I think you were briefed on yesterday.
11 CHAIRMAN JACKSON: Okay. Commissioner Rogers?
12 COMMISSIONER ROGERS: Well, we have heard so much
13 today that I think we are pretty well saturated.
14 I just want to make a remark for Mr. Colvin and
15 that is I think some of his observations are very
16 interesting but I think they need to be more explicit and
17 today at this time is not the time to do that. But I think
18 when you are talking about the need for more efficient
19 safety-related regulation, then I think it is important for
20 you as a representative of the industry to be more explicit,
21 exactly what you are talking about, because I firmly believe
22 that no changes of any sort are going to come about unless
23 there is a very clear identification of exactly what you are
24 talking about and why. But I wouldn't expect an answer to
25 that right now.

1 CHAIRMAN JACKSON: Right.

2 MR. COLVIN: All right, I understand.

3 [Laughter.]

4 CHAIRMAN JACKSON: Right.

5 Commissioner Dicus.

6 COMMISSIONER DICUS: But some day.

7 A question, two real quick ones, I think, to

8 Mr. Harris. I think I heard you say this, I'm not sure, but

9 you believe in mandatory membership in NERC?

10 MR. HARRIS: We think that that is a wise goal.

11 We do not know whether it is achievable when you have full

12 generation competition, people can choose their directions.

13 What we do believe in, however, is the contractual

14 conditions to do business in our pool contractually

15 obligates you to obey the rules of NERC and MAAC, the

16 regional council we are in, and the directions of the

17 control center.

18 By having a contractual relationship that captures

19 that, we think we can cover that gap. It would be laudable

20 if we get to that point but I don't know if in the full

21 generation context you can without some sort of legislative

22 mandate.

23 COMMISSIONER DICUS: That was my follow-up

24 question. If it isn't done by contract, then do you think

25 it has to be done by legislation?

1 MR. HARRIS: Yes, ma'am.

2 CHAIRMAN JACKSON: Commissioner Diaz.

3 COMMISSIONER DIAZ: I have three small questions

4 and maybe some comments.

5 I listened to Mr. Colvin and it follows up on the

6 comments by Commissioner Rogers that I wrote in here, the

7 industry is requiring a defined, stable, safety-focused

8 regulatory infrastructure and you need that for an

9 undefined, deregulated electric marketplace. It seems to be

10 a very tough issue.

11 And then, you know, reasserting what Chairman

12 Jackson, Commissioner Dicus said, I think this coming years,

13 maybe starting now, the value of frequent in-depth

14 communications and advanced probing of this area will be

15 very necessary because we realize that the industry needs

16 some framework but the situation is continuously changing.

17 I think that will require maybe an added incentive for us to

18 be very aware of what your concerns are and those need to be

19 very well stated.

20 If you want to comment to that, fine.

21 MR. COLVIN: Commissioner Diaz, if I might provide

22 one example, to leave the Commission with a concept of what

23 we are discussing, and I might use the discussion that we

24 have had on grid stability and grid reliability over the

25 past seems probably like days to the participants.

1 But if we tie that to the issue of station
2 blackout, I think that this is an issue which the Commission
3 is rightly looking at and needs to look at and assure itself
4 that the safety from the grid reliability standpoint is, in
5 fact, assured.
6 At the same time, however, if you look at the
7 process by which we implemented the safety requirements, the
8 implementation of the station blackout rule, there is a
9 basis, a safety basis which is based upon risk and if you
10 just take a simple look at that and its assumptions, as
11 decided by the rule, you can quickly come to the conclusion
12 that we would have to have more than 50 grid disturbance
13 events in a year to be even starting to penetrate the basis
14 under which that regulation was implemented by the
15 Commission. And you will recall that grid disturbance is
16 only one small portion of the real concern about initiating
17 events, the loss of off-site power. The main disturbance
18 and concern is from a loss of off-site power initiation
19 event is a plant-centered event. So that is the largest
20 portion.
21 So we are really looking -- I think there are many
22 indicators that we have here to look at where we have in the
23 past envelope from a safety basis the real risk to public
24 health and safety. The Commission dealt with that
25 appropriately, the industry dealt with that appropriately,

1 the Commission monitored that activity and, unless there is
2 a significant change that goes outside, puts us outside the
3 envelope under which that safety case was made, then there
4 is no reason to go through and review that safety case and
5 reevaluate and reanalyze that.
6 So I just encourage the Commission from a process
7 standpoint, I think you have in that situation we have the
8 ability to determine today that we are in full compliance
9 with the Commission's safety risk and would do so for some
10 time to come unless grid reliability got to a very
11 significant point of where it was unreliable. I think you
12 have heard the discussions from Mr. Harris and others today
13 to that we are putting in a lot of steps to ensure that
14 doesn't occur.
15 So I was somewhat disappointed in yesterday's
16 discussion of that, that that question was not addressed
17 fairly quickly and fairly easily because, in fact, it is a
18 fairly simple matter to look at the bounding conditions as
19 an industry on what the safety case is.
20 So it is from the process standpoint and if that
21 process now entails each licensee to go reevaluate and
22 reanalyze, I think that is an area where the licensee's
23 resources as well as the Commission's is not well focused
24 because the safety is -- it is easy to determine that that
25 is assured. So it is in that context that my comments

1 should be taken.

2 COMMISSIONER DIAZ: Thank you.

3 The second point was on the Atomic Energy Act. I
4 think we realize that foreign ownership is really becoming
5 an issue and I think that the fuel cycle market is going to
6 become an issue on that and that is another aspect that we
7 are going to really need to look at because it is not only
8 uranium now; it is uranium and plutonium and it is
9 enrichment abroad and it becomes an issue that I think the
10 industry needs to bring if they are going to be going into
11 that area so we can get an early look at it.

12 To accelerate, you talk about grid reliability and
13 I had a comment and maybe a question for Mr. Asselstine.
14 When we wrote, you know, the Atomic Energy Act and the
15 Commission got charged with maintaining national security,
16 it actually meant something. It meant that we were going to
17 control special nuclear materials, that we were going to
18 make sure that technologies that were critical to the
19 proliferation issues were controlled and all those kinds of
20 things that were clearly identified.

21 Now, you know, we are shifting into an area which
22 practically national security is established also in terms
23 of grid reliability and the economics of the country. In
24 that sense, you know, the issue of base plants and nuclear
25 power plants become like a stationary component that has

1 additional importance in determining what national security
2 is as far as economics and grid reliability.
3 Have you dealt with this issue in any way that
4 identifies what a clear contribution of nuclear power plants
5 is in this area?
6 MR. ASSELSTINE: I think to some extent. I think
7 my reaction would be certainly if you look at the number of
8 units that we have and the role that those units play as
9 base load generating units, they are a pretty essential
10 component of the system, now and in all likelihood going to
11 have to continue to be for the most part under a competitive
12 system.
13 That is partly why I am encouraged by the
14 information, at least, that we have available to us that if
15 you have well run plants, those plants should be competitive
16 on a long-term basis under virtually any scenario and, at
17 this stage at least, our own assessment is that relatively
18 few plants should really be vulnerable to early shutdown if
19 they are able to achieve the kind of performance levels that
20 are being achieved by the stronger performers within the
21 industry and you shouldn't see large-scale or at least the
22 risk of large-scale shutdowns of the units simply due to
23 competition.
24 Again, if you break the pieces down, if
25 decommissioning costs are dealt with as a separate matter,

1 if you deal with stranded cost recovery so that you get the
2 capital investment in the plant down to a reasonable level
3 relatively quickly, then you are left with a variable cost
4 analysis. If you run the plants well, they should be
5 competitive on a variable cost basis going forward. If they
6 aren't, then those plants are likely to be as vulnerable or
7 more vulnerable in a truly competitive marketplace.
8 I spoke at another meeting a week or so ago
9 looking at the economic effects on nuclear issues and one of
10 the points that I made was if you begin to separate nuclear
11 out as part of your generation, you need to focus not only
12 on decommissioning costs but also on what happens if you
13 have an extended shutdown of the unit.
14 Somebody in the audience said, basically, you
15 really don't have to worry about that because in a truly
16 competitive marketplace if you have a nuclear generating
17 company and the unit is down for two years, you know what
18 the answer is going to be. That unit won't resume
19 operation.
20 So, if anything, the competitive pressures, I
21 think, are going to put more emphasis on the challenge of
22 running plants well and efficiently and the strong
23 performers are going to be the ultimate survivors.
24 COMMISSIONER DIAZ: Thank you.
25 CHAIRMAN JACKSON: Commissioner McGaffigan?

1 COMMISSIONER McGAFFIGAN: I hate to do this but
2 just three quick questions and I think the answers can be
3 answered quickly.
4 You talked, Mr. Draper, about the need for
5 flexibility in repositioning nuclear assets. You heard the
6 staff earlier say that they are going to basically look at
7 those issues on a case-by-case basis. And if you are
8 looking for flexibility, maybe we have to be case by case.
9 How do we square what you are saying and what the
10 staff said earlier?
11 DR. DRAPER: I am not sure they are inconsistent.
12 It seems to me that we don't want undue delays, we don't
13 want artificial constraints on the way the organizations can
14 be configured as we go forward because one thing we do know
15 is as we go forward people will wish to array their assets
16 in quite different ways from the way they are now.
17 So it seems to me that case by case is fine as
18 long as it is done expeditiously and there are no artificial
19 constraints.
20 COMMISSIONER McGAFFIGAN: And that gets to
21 Mr. Colvin's point about the expeditious nature of the
22 licensing board processes. But how do we give the licensing
23 board, if we don't have reg guides, you know, some template
24 that says, this is okay? How do we give them some way to
25 judge when something comes in?

1 MR. COLVIN: Well, I think we need, and let me
2 follow up on your question if I might. I think we need to
3 look at some templates or some models and we have done that
4 in part with the staff to date to look at some of those. We
5 have identified a lot of other questions that came up. I
6 mean, the whole issue of ISO and its nexus to safety and
7 grid reliability came out of one of those earlier
8 discussions so I thought that was very healthy, so we are
9 going to work with the staff.
10 I think from, just following up on Linn's comment,
11 if you think about the various arrays and the combinations
12 and permutations that you can have, it seems to me the way
13 we've got to start that is not trying to identify all of
14 those but to try to identify some bounding conditions. What
15 are the major factors that are important to the NRC from its
16 safety perspective that relate to the financial ability of
17 the utility to operate within the financial constraints that
18 ensure its safety? If we could identify those in a fairly
19 direct way, I think they are somewhat, and at least in the
20 industry's view, somewhat mushy is probably the best way to
21 talk about it.
22 I mean, they are up there in the eye of the
23 beholder and I think we ought to figure out a way to work
24 together to have the dialogue in this type of forum or
25 whatever forum is appropriate to more crisply define those

1 and do those from the safety perspective.

2 COMMISSIONER McGAFFIGAN: A second question that

3 we have avoided today and I will just ask you.

4 Decommissioning costs we treat as if we know what they are

5 and we have now gone through some decommissionings and as I

6 understand it we have been surprised on the up side as to

7 what the actual costs are. I think at the moment, people

8 just lay aside whatever money we have said might be needed

9 without even a final rule on decommissioning, which we are

10 simultaneously working on.

11 If this is the last chance to get decommissioning

12 costs treated as stranded costs, is anybody looking at

13 whether the numbers are right at the moment? Any of you can

14 answer that.

15 MR. COLVIN: Let me take a crack at that. We have

16 worked hard on that issue with the Commission to try to

17 define that. Mainly, the uncertainties in the

18 decommissioning costs come primarily from uncertainties in

19 low-level waste disposal cost. And given our failure from a

20 national policy perspective to cite low-level waste

21 compacts, then it is all a very interrelated problem.

22 I will say that there are some good methods that

23 are out there and to come up with the best estimates that

24 are available today and then bound those from an uncertainty

25 about the cost of low-level waste disposal. So I think we

1 can get there, here from there. I think that there are
2 discussions in those areas about periodically truing up, I
3 think was the word that Mr. Asselstine used to true up those
4 features. Through that process, we will have to make the
5 appropriate adjustments.
6 It is a true health and safety issue. It is an
7 issue which I think all parties agree needs to be dealt with
8 through nonbypassable or overall charges, wire charges. We
9 just need to figure out the mechanism to deal with that. So
10 I am confident that we can do that.
11 COMMISSIONER McGAFFIGAN: My last question is more
12 a comment. I took during Commissioner Rogers' noting
13 Mr. Colvin's statements about need to align our regulatory
14 framework to safety and the future, and I think it goes to
15 sort of a fundamental issue, if these folks are going to be
16 in a competitive environment, they are going to have to be
17 agile. That is what all the Microsofts and the successful
18 American corporations have to be agile.
19 In the past, we had a ponderous industry dealing
20 with a ponderous regulator and I think there is sort of a
21 challenge to us to figure out how to be a more agile
22 regulator while they are trying to be more agile companies
23 while also preserving safety. So there is a real
24 fundamental issue there but we don't have time today to talk
25 about it, I don't think.

1 I'll leave it at that.

2 CHAIRMAN JACKSON: Well, picking up on that, I
3 would like to thank the NRC staff and members of the two
4 panels representing regulators and the various industry
5 sectors for taking the time to come today to brief the
6 Commission on the developments in the electric utility
7 restructuring.

8 The Commission will continue to gather information
9 about developments in this area and interact with the
10 various sectors to be able to adequately address safety
11 concerns that might arise as a result of any of the issues.
12 I concur with Commissioner McGaffigan's comments and my only
13 parenthetical remark is that presumably we are on that path.
14 It may not be fast enough for everybody and it may not
15 cover everybody's issues all the time. So if we are not on
16 that path, it is our fault.

17 So I would like to think that the actions that are
18 already under way, some completed, as well as the meetings
19 like the ones we have had today and the one on grid
20 reliability contribute to both a comprehensive and a
21 cohesive understanding of the evolving environment which
22 should allow us to respond effectively and in a timely
23 manner to carrying out our public health and safety mission.

24 So we do welcome your input and thank you again
25 and so that we all can continue to enjoy the benefit of a

1 safely operated, soundly and fairly regulated nuclear
2 generated electricity along with the economic benefits of
3 deregulation. I think we have gotten some good input that
4 our staff should fold into any proposed rulemakings or any
5 other initiatives that are under way.
6 So unless my fellow commissioners have any closing
7 comments, we are adjourned.
8 [Whereupon, at 12:18 p.m., the briefing was
9 concluded.]
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25

CERTIFICATE

This is to certify that the attached description of a meeting of the U.S. Nuclear Regulatory Commission entitled:

TITLE OF MEETING: BRIEFING ON ELECTRIC UTILITY RESTRUCTURING - PUBLIC MEETING

PLACE OF MEETING: Rockville, Maryland

DATE OF MEETING: Thursday, April 24, 1997

was held as herein appears, is a true and accurate record of the meeting, and that this is the original transcript thereof taken stenographically by me, thereafter reduced to typewriting by me or under the direction of the court reporting company

Transcriber: Christopher Cutchall

Reporter: Jon Hundley

INDUSTRY RESTRUCTURING ISSUES

Remarks By
E. Linn Draper, Jr.
Chairman, President and Chief Executive Officer
American Electric Power Service Corp.
To the Nuclear Regulatory Commission
Washington, D.C.
April 24, 1997

Thank you Chairman Jackson ... members of the Commission ... we appreciate the opportunity to take part in this session on restructuring of the electric power industry.

I am particularly pleased to be here this morning because I participated in the first of these commission briefings on restructuring in December 1995, as the Chairman may remember.

In terms of regulatory actions, the starting point is the NRC's Action Plan and initial draft proposals to position the NRC for the restructuring of the electric power business.

The draft policy statement, the advance notice of proposed rulemaking on decommissioning, and the draft standard review plans published last year surfaced some of the NRC's major concerns, and allowed the industry to provide its perspective on these issues.

I am here today representing a cross-section of the electric power industry; as a member of the Nuclear Energy Institute's Executive Committee and, since last June, as chairman of the Edison Electric Institute.

I will address the electric utility industry's policy objectives as restructuring proceeds, and outline the more specific goals and objectives established by the nuclear power industry. Joe Colvin will then discuss some of the more significant nuclear regulatory issues.

I think it's fair to say that restructuring of the electric power industry is proceeding at the federal level – and more quickly at the state level – than many people expected even a year ago.

At the federal level, I believe the 105th Congress and the Administration are beginning to recognize that we must approach electricity deregulation and restructuring carefully and deliberately, because the economic and social costs of mistakes are very high. The national interest demands that we get it right.

We must ensure that all consumers of electricity – large and small – will benefit from restructuring, in terms of cost, service and reliability.

We must ensure that the transition to competition recognizes past regulatory commitments by providing for the recovery of, legitimate stranded commitments through the Federal Energy Regulatory Commission and the states.

For policy-makers, the first step is to establish broad areas of responsibility – what decisions should be made at the federal level, what authority should be reserved to the states, and what determinations should be left to the market.

We believe the federal government should articulate general principles and guidance, and address those issues that only the federal government can address – such as possible amendments to the Atomic Energy Act and repeal of the Public Utility Holding Company Act and sections of the Public Utilities Regulatory Policy Act, which are major impediments to competition.

Recognizing that states have differing circumstances, we continue to think the majority of issues are best handled at the state level.

And we believe that some issues – corporate structure, for example – should be left to the market. Government-imposed divestiture, could impede the development of an efficient, competitive market and, thus, should be avoided.

Turning to the state level, based on what we have seen in states like California and Pennsylvania which have significant nuclear capacity, we are generally encouraged by the responsible manner in which state government officials – regulators, legislators and governors – are approaching restructuring.

We are particularly encouraged by the explicit recognition in both California and Pennsylvania that nuclear power plant decommissioning is a public health and safety imperative, and that decommissioning funding must be assured.

We recognize that decommissioning funding assurance is one of the NRC's major concerns, and rightly so. And we believe the NRC can, and should, take considerable comfort from the way states have handled this issue so far.

Let me assure you that the nuclear industry also regards decommissioning as a national public health and safety imperative, and considers assurance of decommissioning funding as one of our highest priorities.

Let me turn now to the nuclear industry's major goal as restructuring proceeds [*slide 1*] and the objectives we have formulated to enable achievement of that goal.

Our goals are very simple: *{slide 2}* to maintain excellence of safety performance and ensure that nuclear power plants are not placed at a competitive disadvantage as restructuring of the electric power industry proceeds.

To reach these goals, the industry has established four specific objectives. These are not in rank order. All are equally important.

First, *{slide 3}* we must provide the industry with maximum possible certainty and clarity about future nuclear regulatory requirements as companies consider restructuring options – including consolidation of nuclear operations, ownership transfers, and the like.

Second, *{slide 4}* we want to ensure that companies have maximum possible flexibility to reposition their nuclear generating assets, without subjecting those nuclear units to unnecessary economic penalties or financial stress.

Obviously, NRC regulations and requirements – particularly in the area of financial assurances – will play a major role here.

Third, *{slide 5}* in federal or state legislation, the industry believes that nuclear utilities should have a reasonable opportunity to recover stranded costs, including unrecovered capital and unfunded decommissioning obligations.

Finally, *{slide 6}* we believe it is appropriate to undertake a critical examination of certain provisions of the Atomic Energy Act to determine whether the conditions that justified those provisions still prevail. If conditions have changed, then we believe the Atomic Energy Act should be clarified or amended.

Joe Colvin will cover several specific nuclear regulatory issues {*Slide 7*}.

NRC requirements and regulations are one of the critical factors that will influence the nuclear industry's business decisions going forward; including the degree of flexibility available to licensees as they consider how best to position their nuclear power plants for a competitive environment.

One of the major tasks as we move forward will be to define those issues and areas which involve nuclear safety and thus are within NRC's purview, and those critical issues that fall outside the NRC's statutory mandate.

Recovery of stranded commitments is a critical issue that falls outside the NRC's statutory mandate. Various NRC officials have expressed concern recently about recovery of stranded commitments.

Although recovery of stranded commitments is one of the industry's major issues, and although we would welcome NRC's support for the general principle that companies should be allowed a reasonable opportunity to recover, legitimate,

and verifiable stranded commitments, we do not believe recovery of stranded commitments is a legitimate NRC safety issue.

Recovery of stranded commitments involves whether or not a company will be able to meet its fiduciary obligations to its shareholders and bondholders. It is entirely separate from operating economics, which will determine whether a nuclear power plant – or any power plant – will continue to operate.

We believe the public interest is best-served if the NRC focuses on results, on answering the key question: What are we trying to achieve?

The answer, we would assume, is "to continue to ensure adequate protection of public health and safety".

So how do we separate the success path for this objective? The NRC might have started this process by articulating the issues on its mind regarding nuclear power plants operating in a restructured, competitive market.

Now, the NRC must engage the industry in a substantive discussion about whether or not those issues are important, then develop practical mechanisms and techniques to address the important issues.

Let me now turn the microphone over to Joe Colvin, NEI's president and CEO, for the second half of our presentation, after which we will be happy to answer your questions.

Industry Restructuring Issues

Remarks By
E. Linn Draper, Jr.
Chairman, President and Chief Executive Officer
American Electric Power Corp.

Nuclear Industry Goal

Maintain excellence in safety performance, and ensure that nuclear power plants are not placed at a competitive disadvantage as restructuring of the electric power industry proceeds.

Industry Restructuring Objectives

- **Provide the industry with maximum possible certainty and clarity about future nuclear regulatory requirements as companies consider restructuring options--including consolidation of nuclear operations and ownership transfers.**

Industry Restructuring Objectives

- [illegible]
- **Ensure that companies have maximum possible flexibility to reposition their nuclear generating assets, without subjecting those nuclear units to unnecessary economic penalities or financial stress.**

Industry Restructuring Objectives

- Clear regulatory requirements
- Flexibility
- **Ensure that nuclear utilities have a reasonable opportunity to recover stranded costs, including unrecovered capital and unfunded decommissioning obligations.**

Industry Restructuring Objectives

- Clear regulatory requirements
- Flexibility
- Recovery of stranded costs
- **Undertake a critical examination of certain provisions of the Atomic Energy Act to determine whether the conditions that justified those provisions still prevail.**

Industry Restructuring Objectives

- Clear regulatory requirements
- Flexibility
- Recovery of stranded costs
- Review of Atomic Energy Act

PRESENTATION OUTLINE

- NRC RESTRUCTURING ACCOMPLISHMENTS
- NRC REVIEW OF LICENSEE RESTRUCTURING
- EMERGING ISSUES
- ISSUES TO BE RESOLVED
- SUMMARY & CONCLUSIONS

NRC RESTRUCTURING ACCOMPLISHMENTS

- ACTION PLAN ISSUED IN FEBRUARY 1996.
- ADVANCE NOTICE OF PROPOSED RULEMAKING (ANPR) ON DECOMMISSIONING FUNDING ASSURANCE.
- ADMINISTRATIVE LETTERS.
- DRAFT POLICY STATEMENT PUBLISHED SEPTEMBER 23, 1996. FINAL POLICY STATEMENT UNDER STAFF REVIEW.
- DRAFT STANDARD REVIEW PLANS (SRPs) NOTICED FOR PUBLIC COMMENT IN FEDERAL REGISTER ON DECEMBER 27, 1996.
- STAFF-LEVEL LIAISON ACTIVITIES WITH STATE AND FEDERAL RATE REGULATORS.
- OTHER -- FINANCIAL ACCOUNTING STANDARDS BOARD (FASB) INITIATIVE & § 50.80 PROCESS REVIEW.

NRC REVIEW OF LICENSEE RESTRUCTURING

- SRPs HAVE DEFINED/SUMMARIZED CURRENT REVIEW PROCESS.
- NRC REVIEWS ALL RESTRUCTURING PROPOSALS UNDER § 50.80 REQUIREMENTS.
- NRC ENSURES THAT RESULTING LICENSEE REMAINS AN "ELECTRIC UTILITY" OR COMPLIES WITH ADDITIONAL REQUIREMENTS FOR NON-ELECTRIC UTILITIES.
- FOR HOLDING COMPANIES, STAFF CONTINUES TO OBTAIN COMMITMENTS TO INFORM THE NRC WHEN SIGNIFICANT ASSETS WILL BE MOVED FROM A LICENSEE TO A PARENT OR AFFILIATE.

EMERGING ISSUES

- GRID RELIABILITY/ISOs.
- UNIQUE OWNERSHIP AND OPERATOR ARRANGEMENTS.
- ANTITRUST.
- STATE APPROACHES TO SECURE ADEQUATE REVENUE STREAMS FOR DECOMMISSIONING.

ISSUES TO BE ADDRESSED

- MODIFICATION TO § 50.80 REVIEW PROCESS AND OTHER REVISIONS TO FINANCIAL QUALIFICATIONS FRAMEWORK.
- BALANCING INDUSTRY REQUEST FOR DEFINED NRC POSITION ON ADEQUACY OF FINANCIAL ASSURANCE WITH UNCERTAINTY AND VARIETY OF CURRENT AND FUTURE STATE APPROACHES.
- ACCEPTABILITY OF LEVEL OF DECOMMISSIONING FUNDING ASSURANCE PROVIDED BY SOME STATE RESTRUCTURING APPROACHES.
- AVAILABILITY OF FUNDING ASSURANCE MECHANISMS TO NON-ELECTRIC UTILITIES.
- EVALUATION OF NEED FOR FEDERAL LEGISLATION.
- FOREIGN DOMINATION AND CONTROL -- PROHIBITION IN ATOMIC ENERGY ACT.

SUMMARY & CONCLUSIONS

- ALTHOUGH DEREGULATION APPEARS TO BE ACCELERATING OVERALL, SEVERAL STATES WITH NUCLEAR PLANTS HAVE NOT YET INITIATED EXTENSIVE DEREGULATION INITIATIVES.

- THE NRC HAS INITIATED A SERIES OF ACTIONS THAT, TOGETHER WITH ITS CURRENT REGULATORY FRAMEWORK, SHOULD PROVIDE ADEQUATE ASSURANCE OF FUNDING OF OPERATIONS AND DECOMMISSIONING OF POWER REACTORS.

- THE NRC WILL CONTINUE TO EVALUATE ITS LICENSEES IN THE CONTEXT OF EACH STATE'S DEREGULATION POLICIES AND PROGRAMS TO DETERMINE WHETHER THEY PROVIDE ADEQUATE FUNDING FOR OPERATIONS AND DECOMMISSIONING.

WRITTEN STATEMENT OF
THE NATIONAL ASSOCIATION OF
REGULATORY UTILITY COMMISSIONERS
BEFORE THE
NUCLEAR REGULATORY COMMISSION

BRIEFING ON ELECTRIC UTILITY RESTRUCTURING

APRIL 24, 1997

The National Association of Regulatory Utility Commissioners (NARUC) is pleased to submit this written statement to support the oral statements to be presented by three of its members: Commissioner Bruce B. Ellsworth of New Hampshire, NARUC President, Commissioner Robert W. Gee of Texas, Chair of NARUC's Committee on Electricity, and Commissioner Emmit George of Iowa, Chair of NARUC's Subcommittee on Nuclear Issues. We respectfully request that the NARUC's written statement be included in the Nuclear Regulatory Commission's record of the Briefing.

The NARUC is a quasi-governmental nonprofit organization founded in 1889. Within its membership are the governmental bodies of the fifty States engaged in the economic and safety regulation of carriers and utilities. The mission of the NARUC is to serve the public interest by seeking to improve the quality and effectiveness of public regulation in America. More specifically, the NARUC is comprised of those State officials charged with the duty of regulating the retail rates and services of electric, gas, water and telephone utilities operating within their respective jurisdictions. We have the obligation under State law to assure the establishment and maintenance of such energy utility services as may be required by the public convenience and necessity, and to ensure that such services are provided at rates and conditions which are just, reasonable and nondiscriminatory for all consumers.

The Association greatly appreciates the opportunity to submit this statement in conjunction with the NRC's Briefing on Electric Utility Restructuring. The NARUC recognizes the compelling need for the economic regulators within its membership to work closely with the Commission and its staff during this time of unprecedented change in the electric utility industry. We applaud the Commission for seeking to understand the critical role that State commissions are playing in the transition to a more competitive electric utility industry. For its part, the NARUC again pledges to cooperate fully with the NRC as it reviews its responsibility to ensure the safe operation of the nation's nuclear generating capacity in the new economic environment.

The States' Historical Role in Changes to Utility Regulations

The Association has a unique perspective to bring to the Commission's Briefing inasmuch as the existing structure of the investor-owned electric utility industry is predominantly a creature of State economic regulation. Historically, the industry was one of the three basic "natural monopolies" (along with telephony and natural gas delivery) which was the product of decisions made in almost every State to certificate a single company to provide service to all retail customers in an exclusively franchised service territory. In exchange for the insulation from competition that this exclusivity provided, electric utilities were subjected to a regulatory regime which limited their profits and earnings to levels found just and reasonable by their regulators. Until 1992, this system of regulated monopoly service providers was left unchanged because it was viewed as the most economically efficient means of providing essential services to retail consumers at reasonable rate levels. The result has

been to produce the most economical electricity rates among those Western industrialized nations not heavily dependent on hydropower sources of energy.

Times and fashions change, of course, and now the electric utility industry is the last of the three to undergo a transformation from monopoly franchise to market participant, and like the transformation of those industries, States are again leading the charge to restructure retail electric markets. Indeed, while the idea of injecting market forces into regulated industries began to be debated in universities and think tanks, actual tests of such theoretical debates began in various States -- first in the formerly regulated transportation industries (notably airlines and motor carriers) and then the fixed utilities, beginning with natural gas wellhead pricing in the producer States, then telephony, and now electricity. In each case, the States performed their critical duty to act as laboratories to test theories and new practices to determine how the forces of competition could be brought to bear to improve rates and services to customers while maintaining the important principles of reliability, safety, and environmental sensitivity that the prior regulatory model had fostered.

What's Happening Today in the States

And the testing of theory and practice continues apace. Last year, NARUC's President testified before the Congress on the state of the States, and reported then that one State commission (California) had authored a comprehensive restructuring program while another (New Hampshire) had begun a pilot program to test the application of an unbundled retail electric system on a limited basis. Today, ten States have had either laws adopted or their State commissions propose comprehensive reforms to their retail electric utility structures

aimed at promoting greater competition by offering customers a choice of suppliers. Many other State commissions have made restructuring recommendations to their respective State legislatures. All but one of the fifty States, either through their regulatory commissions, legislatures or both, are considering or implementing policies to provide greater competitive options for retail electric consumers.

Some have argued that this level of activity is too slow, others too fast. Regardless, it is apparent that the pace of change has quickened: Nine of the ten States that are far down the path to opening their local markets to competition have chosen to do so only in the last nine months, and customers residing in these States represent over one-third of the nation's population. Stated another way: More than one-third of the nation's population live in States that have chosen within the last year to move to open-access, customer choice markets. Moreover, given the level of activity in the many of the remaining States, it is not at all implausible to expect that very soon (by 2000), the majority of utility customers will have the ability to choose competitive power suppliers, that is, to buy power generated by someone other than the distribution utility that provides the delivery service.

Despite this level of activity, however, it is important to recognize that State commissions and legislatures are acting with great care and precision to ensure the reliability of retail electric services and the universality of both services and benefits resulting from restructured markets. The States' intentions, and the NARUC's hope, is that we all can learn from these and other initiatives about what works and what does not in a controlled environment without causing collateral damage to the broader consuming public through the fine tuning and re-engineering of State-level implementation plans that is sure to occur.

Status of State Initiatives

Against this general background, we can provide the Commission more specific information on the activities transpiring in the various States as it relates to restructuring the industry, as well as NARUC's views of these restructuring efforts.

States on the leading edge of restructuring include Arizona, California, Maine, Massachusetts, New Jersey, New Hampshire, New York, Pennsylvania, Rhode Island, and Vermont. Three States -- California, Pennsylvania and Rhode Island -- recently enacted into law, and are currently implementing, electric restructuring plans. Last year, the State of New Hampshire began its phased implementation of customer choice programs through its limited pilot program. A Final Order by the New Hampshire Public Utilities Commission laying out a complete restructuring program was issued on February 28 as directed by its State legislature. Other State commissions, like those in Arizona, Massachusetts, and Vermont, have proposed comprehensive retail market restructuring programs. Still others, like Maine, Texas and New Jersey, have forwarded restructuring recommendations to their respective legislatures for consideration. Various State legislatures, like those in Colorado, Connecticut, Montana and Oregon, are considering restructuring legislation that most often have included State commission or Governor recommendations. Attached hereto is a "scorecard" prepared by our affiliated research arm -- the National Regulatory Research Institute -- which shows the status of State restructuring activities through the end of March.

Other States have decided either not to move forward with plans to restructure local markets, or to move at a slower pace. These States, whose customers generally benefit from low-cost power supplies, are genuinely concerned about the possibility that their inexpensive

power supplies will be sold elsewhere in an unbundled, competitive environment, causing their local customers to pay more for power than now purchased through the existing cost-based regulatory system.

Within the context of restructuring initiatives, while many of the initiatives being implemented or contemplated take various forms and are at various stages, those approved address important issues in very similar ways and are to be completed in relatively similar timeframes. For instance, some of the issues States have contemplated or addressed in their restructuring plans are customer choice through retail wheeling; rate reform through the adoption of performance-based ratemaking structures and economic development rates; elimination of exclusive retail service territories; recovery of stranded costs; and the continued provision of public purpose programs.

More specifically, we are now able to discern the following trends in State legislative and regulatory initiatives:

Stranded Costs

The first trend States are addressing relates to recovery of utilities' prudently incurred, verifiable, non-mitigatable costs left uneconomic due to new, competitive pressures. Since the vast majority of these costs are scheduled to be recovered in retail rates, this issue has landed -- and rightly so -- in the laps of State commissioners who are in the process of developing policies that reduce the size of the stranded cost problem and fairly allocate the costs that will not be recoverable in the competitive market.

In looking at the stranded cost problem, we need to keep in mind a few important factors. First, not all utilities are threatened by the competitive market. Many utilities, including utilities owning nuclear plants, are relatively low-cost producers capable of facing competitive alternatives. Second, if State commissions are allowed to continue to set the pace of restructuring, utilities can be provided time to reduce the level of costs that are strandable before competitive forces begin to dictate the market's operation. Finally, in order to address exactly who pays for stranded costs, State commissions are now in the process of developing cost recovery mechanisms, such as nonbypassable, competitively neutral wires charges and exit fees that are adapted to local market conditions and past regulatory decisions.

At this point is important to note that the States have been particularly sensitive to one category of costs that nuclear utilities confront - the cost of decommissioning. The NARUC believes that based upon the decisions thus far made, the States can be expected to ensure that decommissioning expenses are funded. In this regard, we note that in their respective restructuring policies, both California and Pennsylvania specifically addressed decommissioning funding as part of the Competitive Transition Charge (CTC). This policy will ensure that all customer classes support this necessary cost of service. We continue to support the NRC's efforts to closely monitor this situation, along with the ownership and financial issues raised in the Commission's recently-issued proposed policy statement.

Unbundling

Second, electric utilities will be required to offer services competitively at both wholesale and retail on an unbundled basis, requiring changes to the vertically integrated utility structure. Such changes may range from functional unbundling (wherein a utility offers its generation, transmission and distribution services priced and provided separately), to corporate restructuring (wherein the utility establishes separate corporate subsidiaries to provide generation transmission or distribution services), to more comprehensive structural reform involving spin-offs of ownership of generation, transmission or distribution. At this time, we know of no State that has ordered or required divestiture of a line of business such as generation, although utility companies in both New England and California have agreed to sell generating capacity on a voluntary basis as part of a larger restructuring package.

Pricing

The third area of change involves pricing. With implementation of retail customer choice, the likely result will be a movement from a cost-based system for pricing generation services to a system based on contracts between power suppliers and customers, presumably priced at market. We expect to see consideration of performance based models that use price caps (as in California) in place of traditional cost based models, although during the transition to full competition, some States are considering programs which allow retail customers to choose a standard-offer service provided at traditional cost of service. With respect to transmission and distribution, it is likely that the FERC (with respect to transmission services) and the States (with respect to distribution) will continue to rely on cost based models, given that in each case, transmission and distribution will remain monopoly services.

Regionalization

A fourth trend is the regionalization of electric markets. Increasingly, transmission planning will be conducted on a regional basis to meet the needs of multi-State bulk power markets. Such transmission systems, serving region-wide power pools, may be operated by independent system operators (ISOs) and similar perhaps to the New England ISO currently being developed by the NEPOOL and State regulators, and the California ISO, which has been given preliminary approval by FERC and the California commission. Bulk power markets will be priced regionally as well.

Public Benefits

A fifth trend is the preservation of public benefit programs. States are developing groundbreaking mechanisms to continue providing public purpose programs that local consumers desire regardless of the structure of the market. Such programs include those which support low-income assistance, energy conservation, use of renewable energy, and research and development. All State programs being considered or implemented ensure continued universal service.

Implementation Issues

States that have begun to implement electric restructuring programs are also experiencing challenges that need to be resolved before retail open-access policies are fully put into practice. Such implementation issues include: establishing customer choice education programs, and securing requisite funding to carry out such programs, to ensure the success of newly restructured markets; creating meaningful consumer protection programs to

safeguard against potentially abusive practices; developing the terms and conditions of services with which market entrants must comply; deploying innovative real-time pricing and metering technologies for the benefit of all retail customers.

One very large implementation issue concerns the question of industry market power, particularly in light of the ongoing trend of mergers and acquisitions. We understand the NRC's concern that changes in plant ownership, creation of holding companies and generally increased corporate complexity present new challenges to the Commission's regulatory programs. The State commissions share these concerns, both as it relates to questions of safety and system reliability, but also, to the impact of industry consolidation, aggregation of market power, and affiliate self-dealing will have on the economic well-being of retail customers.

The NARUC's View On State and Federal Restructuring Initiatives

While State restructuring activities were ongoing, and Congress became interested in looking to comprehensively restructure the industry legislatively, the NARUC spent most of 1996 deliberating over how the Association should respond to State restructuring efforts around the country, how the NARUC could help such efforts move forward and what measures proposed at the Federal level could be supported. In July of last year, the NARUC adopted its "Principles to Guide the Restructuring of the Electric Industry" (also attached to this statement). The Principles support States' market restructuring initiatives to provide customer choice along with programs that ensure the continued provision of adequate, safe, reliable and efficient energy services at fair and reasonable prices at the lowest long-term cost

to society. Also, the Principles reiterate the NARUC's position that States should decide whether, when and how to restructure local markets.

These Principles also support:

- Enabling customers to make informed choices among electricity suppliers;
- Maintaining or improving network integrity;
- Ensuring customer access to reasonably priced services, including adequate protections for low-income customers;
- Protecting consumers from anti-competitive behavior, undue discrimination, poor service and unfair billing and disconnection policies;
- Ensuring the maintenance or improvement of public benefit and environmental programs through existing or new mechanisms;
- State determinations of retail stranded cost recovery mechanisms; and
- State determinations of retail electric restructuring policies, and authorization for States to create regional mechanisms to address transmission, reliability, market power and other regional concerns.

Conclusion

It was just about a decade ago that respectable voices were raised in great alarm imploring the industry to build, and State and Federal decision makers to approve, many large base-load power plants -- particularly nuclear -- to forestall the supply crunch that was seen as inevitable in the late '80s and into the early '90s. Of course, it didn't happen. Needless to say, forecasting the future of the electric industry is perilous business. The best (and safest) place to start is what should happen in the near term. The States are now performing their historic role as laboratories to test how the words "greater competition for retail consumers" can be turned into real-world services that customers will buy. As the FERC moves forward in its implementation of Order 888, the State commissions and legislatures must be allowed to continue to experiment with retail access, including customer choice initiatives. As the consequences of competitively based wholesale markets become clearer, States are beginning

to put in place complementary retail policies which are adapted to regional market conditions. State commissions are developing and implementing compatible retail policies which provide for stranded cost recovery, preserve reliability, prevent the stranding of "public goods," ensure consistency with environmental values, minimize cost shifting, and most importantly, improve economic efficiency. Over time, States will work together, as some are now doing, to devise and implement regional institutions to adapt their regulatory responsibilities to the reality of regional power markets.

While these activities are underway on the economic front, it will remain a critical factor that the economic regulators -- FERC and the State commissions -- understand and take into account the policies developed by the safety regulators -- the NRC. And of course, the dialogue must go in both directions as the Commission comes to grips with the effect changing wholesale and retail power markets can be expected to have on the ownership, operation and decommissioning of nuclear generating stations.

In closing, the NARUC is pleased with the heightened level of discussions between NARUC and the NRC at both the Commissioner and the staff levels. We are particularly grateful for the role Commissioner Kenneth Rogers and his staff have played in acting as a liaison to NARUC. We look forward to the continuation of a productive relationship with the Chairman and newly appointed Commissioners in the months ahead.

Thank you.

Electric Industry Restructuring Box Score

31-Mar-97

National Regulatory Research Institut
http://www.nrri.ohio-state.edu

State	No Activity	Discuss, forum	Staff Report	NOI, Invest.	Guide-lines	Draft Order	Comm. Hrngs.	Final Order	Trial or Expt.	Utility Plan	Approve Plan	Legis. Study	Bill Intro.	Bill Passed	Failed or Veto	Court Lit.	Exec. Study
AL		*											*			*	
AK		*		*			*										
AZ		*	*	*		*		*		*		*	*			*	
AR		*								*							
CA		*						*		*			*	*			
CO		*	*	*									*		*		
CT				*	*							*	*				*
DC				*						*							
DE				*			*			*		*					
FL		*										*			*		
GA		*											*				
HI				*									*				
ID		*		*	*	*	*		*		*	*					
IL		*	*						*			*	*		*		
IN		*	*							*		*	*		*		
IA		*	*	*	*		*			*							

Electric Industry Restructuring Box Score

31-Mar-97

National Regulatory Research Institut
http://www.nrri.ohio-state.edu

State	No Activity	Discuss, forum	Staff Report	NOI, Invest.	Guide-lines	Draft Order	Comm. Hrngs.	Final Order	Trial or Expt.	Utility Plan	Approve Plan	Legis. Study	Bill Intro.	Bill Passed	Failed or Veto	Court Lit.	Exec. Study
KS		*		*								*	*				
KY		*															
LA			*	*	*					*							
ME		*	*	*	*	*	*			*		*	*				
MD		*	*	*	*		*	*									
MA				*		*	*	*	*	*	*	*	*				
MI		*	*			*	*		*	*						*	*
MN		*	*	*	*							*	*		*		
MS		*		*						*		*	*				
MO		*								*		*					
MT		*			*							*					
NE												*					
NV				*	*							*			*		
NH					*	*	*	*	*				*	*		*	
NJ		*	*	*				*	*	*							
NM				*						*	*	*	*				

Electric Industry Restructuring Box Score

31-Mar-97

National Regulatory Research Institut
http://www.nrri.ohio-state.edu

State	No Activity	Discuss, forum	Staff Report	NOI, Invest.	Guide-lines	Draft Order	Comm. Hrngs.	Final Order	Trial or Expt.	Utility Plan	Approve Plan	Legis. Study	Bill Intro.	Bill Passed	Failed or Veto	Court Lit.	Exec. Study
NY		*			*		*	*	*	*		*	*			*	
NC		*		*								*					
ND		*		*		*						*	*				
OH		*		*	*	*			*	*		*	*				
OK		*		*	*		*					*	*		*		
OR		*							*	*		*	*				*
PA			*	*	*		*		*	*			*	*			*
RI			*		*					*			*	*			
SC		*	*										*				
SD		*															
TN	*																
TX			*	*	*	*		*		*			*				
UT		*	*	*	*							*	*				
VT		*		*	*	*	*	*		*							*
VA		*	*	*								*	*				
WA				*	*				*	*							*

Electric Industry Restructuring Box Score

31-Mar-97

National Regulatory Research Institut
http://www.nrri.ohio-state.edu

State	No Activity	Discuss, forum	Staff Report	NOI, Invest.	Guide-lines	Draft Order	Comm. Hrngs.	Final Order	Trial or Expt.	Utility Plan	Approve Plan	Legis. Study	Bill Intro.	Bill Passed	Failed or Veto	Court Lit.	Exec. Study
WV		*		*													
WI		*	*	*	*	*	*			*		*					
WY		*	*		*												
Totals	1	36	19	31	21	11	14	9	11	24	3	26	27	4	7	5	6

0 Commissions (denoted by suffix -a above) have not returned the survey.

Resolution Adopting
"Principles to Guide the Restructuring of the Electric Industry"

WHEREAS, State commissions and legislatures, the Federal Energy Regulatory Commission (FERC) and the Congress are in the process of developing and implementing new policies to move the electric industry to reliance on greater competition in the marketplace; and

WHEREAS, It is appropriate that the National Association of Regulatory Utility Commissioners (NARUC), as the national representative of the State regulatory commissions, adopt principles providing guidance to State and Federal decisionmakers to ensure that this transition serve the interests of consumers, providers, the national economy and the public good; now, therefore, be it

RESOLVED, That the Executive Committee of the National Association of Regulatory Utility Commissioners (NARUC), convened at its 1996 Summer Meeting in Los Angeles, California, hereby adopts the attached "Principles to Guide the Restructuring of the Electric Industry" and urges that State and Federal regulatory commissions and legislatures be guided by these principles as they develop and implement new policies to govern the regulation, organization and operation of the electric utility industry.

Sponsored by the Ad Hoc Committee on Electric Industry Restructuring and the Committees on Electricity, Energy Conservation and Gas
Adopted July 25, 1996
Reported NARUC Bulletin No. 32-1996, page 10

NARUC Principles
To Guide The Restructuring of the Electric Industry

Introduction to the NARUC Principles

As the nation's electric industry becomes more competitive, decision-makers should be guided by certain principles. Since its inception, regulation has sought to safeguard the public interest and to ensure economic efficiency. These goals should remain.

General Principle

Consumers should have access to adequate, safe, reliable and efficient energy services at fair and reasonable prices at the lowest long-term cost to society. Structural changes in the industry should be encouraged when they result in improved economic efficiency and serve the broader public interest.

This general principle should remain the goal for all restructuring proposals. Many of the specific principles listed below will be in tension and will require balancing in light of this general principle.

Commentary

The general principle describes the overarching goals of public policy in providing energy services to the nation's consumers. These goals should remain, regardless of the market structure through which services are delivered. This general principle encourages policy-makers to consider the effects that restructuring initiatives will have on the long-standing goals of regulation and public policy, and to develop mechanisms (market-based or otherwise) that will preserve the beneficial public interests of the current electric system. The principle also recognizes that restructuring holds the potential for additional benefits to society, in the form of increased economic efficiency, and that it is incumbent upon policy-makers to seek to capture those benefits when doing so is consistent with the broader public interest.[1]

---

[1]By economic efficiency we mean efficiency in the production and consumption of goods and services. Societal welfare is improved as economic efficiency is increased, which is to say that scarce resources are put to their most highly valued uses and are used most efficiently in production. There are several components of economic efficiency: (a) allocative efficiency (when society's resources have been organized for productive purposes in such a way that it would be impossible to reorganize them to benefit one party without making another party worse off); (b) productive efficiency (a given quantity of output is produced at the lowest possible total cost); and (c) other production efficiencies (associated with management of the production process). Furthermore, this notion of efficiency is not limited to merely static efficiency, but also includes dynamic efficiencies (such as innovation and technological development) that arise over time from the stimulus of competition in an environment in flux.

Specific Principles

NETWORK INTEGRITY

The safety, reliability, quality and sustainability of electric service should be maintained or improved in a restructured electric industry.

Market-based decisions, driven by economics and competition alone, could jeopardize critical safety and reliability and long-term strategic resource and facilities planning. Public policy should ensure the integrity of the electric grid and encourage prudent long-term resource planning, acquisition and utilization.

Commentary

Restructuring should not jeopardize the safety, reliability or quality of electric service. The importance of a reliable electric system cannot be overemphasized. Consumers now rely on very high service quality; their well-being, and the country's economic growth, require that it be maintained. No changes in the electric utility industry or the regulatory regime should be allowed to compromise reliability, even if the intention is to lower consumer prices, except where a lower level of reliability is freely chosen by a customer and does not impair service to other customers (*e.g.*, interruptible service).

As the industry moves toward a more competitive model, traditional means of ensuring a diverse long-term power supply may give way to more market-based mechanisms. Policy-makers should carefully monitor this transition and should be prepared to create new mechanisms to assure that state goals in these areas are being properly addressed in such markets.

Any restructuring plan should be designed to preserve sufficient latitude and flexibility for the States to take actions, consistent with federal policy, to ensure that safety, reliability and quality concerns are satisfied. Transmission system operators should have the authority and means to continue the provision of safe and reliable electric service, while at the same time facilitating a competitive generation market. The integrity of the transmission system should be assured regardless of how it is operated.

UNIVERSAL SERVICE

Universal service at reasonable rates, including adequate protections for low-income customers, should be maintained.

Because electricity service is vital for health, safety and economic opportunity, universal service is a cornerstone of the public interest. Customers are entitled to access to reasonably priced power, and to a forum for dispute resolution.

Commentary

Electric service is a basic need. Therefore, preserving and protecting the public interest in a restructured electric industry should include assuring that consumers have access to an adequate supply of electricity to satisfy their basic needs at a reasonable price. Policy-makers

should continue to address the needs of low-income customers. The health and safety of all consumers is paramount.

Defining universal service will be a critical issue. Continuing and improving universal service involves two goals: maintaining service for those who already have it and expanding service to those who do not yet have it. Continuing and expanding customer access to basic electric services should be done in a way that is both economically efficient and fair. While all customers should be entitled to non-discriminatory access to the electric system, for some customers the most efficient and affordable means of obtaining basic energy services might not be through a connection to the electric grid, but through combinations of demand-side management measures and renewable and fossil-based distributed or self-generation. Restructuring initiatives should be designed to accomplish universal service goals at the lowest cost to society. In order to minimize market distortions, the price for grid connections should be cost-based, and any subsidies should be explicit.

CUSTOMER CHOICE

Customers should have the opportunity to make informed choices among electricity providers and services.

The potential for competition to improve economic efficiency rests on having multiple service providers as well as informed consumers. Market development should be guided in a way that increases the role of competition among energy service providers and the role of choice for customers.

Commentary

All types of customers have expressed a preference for choosing their electricity providers and services. This is particularly true for commercial and industrial customers, who maintain that increased customer choice would lower prices. Residential customers and others are also beginning to express their desire to share equally with business customers in enjoying the benefits of increased customer choice.

Customers acting in their own self-interest, when presented with a variety of market choices, will tend to arrange their consumption to maximize their welfare, save costs and enhance their satisfaction. Allowing customers to choose not only encourages the development of new providers who would engage in creative marketing, but also permits a dissatisfied customer to change providers. If electric industry restructuring is guided prudently, customer choice is likely to result in a greater variety of pricing options, including innovative rate designs and lower prices, as providers compete with one another to deliver services to customers. Further, this competition will bring with it a greater incentive to provide diverse terms, conditions and payment plans in response to customer interest and needs.

While the general theme of customer choice holds appeal, markets in the electric industry cross the country are at different stages of development and contain different potentials for cost savings and service alternatives. Knowledge of local markets is the preferred basis for

determining how customer choice can best be implemented to result in greater benefits to all participants. Thus, it is for the States to determine the extent of and pace for expanding choice for customers under their regulatory oversight.

CONSUMER PROTECTION

Consumers should be protected from anti-competitive behavior, undue discrimination, poor service and unfair billing and disconnection practices.

Regulatory processes should continue where effective competition is absent and where monopolies and other forms of market power remain. Market power concerns are particularly relevant when considering electric utility mergers and acquisitions.

Commentary

In a restructured industry, certain consumer protections should be preserved, particularly those that guard against undue discrimination, failure to meet minimum service quality and safety requirements and other unfair business practices. In a competitive environment, other consumer abuses such as deceptive marketing practices should also be prevented. Associated with these issues are questions of service quality, providers of last resort and the obligations of distribution companies.

Policy-makers should also assure the continued, efficient operation of the competitive generation market. The potential for providers to amass market power sufficient to allow them to raise prices above competitive levels will remain a central public policy concern. Protecting against this problem may involve the development of appropriate standards for entry, ownership, bidding, operation and other market behavior.

PUBLIC PARTICIPATION

Industry restructuring policies should be developed in public processes with participation open to all.

All stakeholders should receive fair consideration in public processes.

Commentary

Electric restructuring will affect every person, either directly or indirectly. Even individuals not tied to the electric grid will be affected by restructuring and by consumer products that become available as an indirect result of restructuring. There is an inherent responsibility for policy-makers and industry to develop a strategy for public participation in the formation of restructuring policies.

In many ways, the task may seem daunting because of the breadth of stakeholders and the scope of issues. But electricity use is intertwined in our daily lives, affects the environment and other public interests and is essential to the economic well-being of our industries and businesses. There should be a commitment to bring diverse ideas into the discussion and to

address the questions and concerns of the public.

The techniques and tools of public participation will vary depending on the timing of and participants in the process. While at times the commitment to public participation may appear to slow the restructuring process, in the long run it will result in an improved process and smoother transition. Public participation is time and resource intensive, and it is best to acknowledge these needs early in the process because it will be demanding of policy leaders in both the regulatory agencies and industry. While public participation does not mean that all of the public must agree on the outcome of restructuring, it does mean that all members of the public should have the opportunity to be heard, be treated fairly and be provided with clear and accurate information.

SHARED BENEFITS

All classes of customers should benefit from improvements due to structural changes in the industry.

Electric industry restructuring should be done in a way that benefits all customer classes fairly and does not unduly disadvantage any customer class nor preserve any undue cross-class subsidy.

Commentary

Decisions concerning how and to what extent customer choice should be expanded among the customer classes should be left to the States so that orderly access to the benefits of restructuring occurs. Given their knowledge of and experience with the local history of rates, rate designs and cost allocations for all customer classes, the States can best address how to alleviate undue subsidies among customer classes.

All customer classes should have access to electricity suppliers, and applicable laws and rules should require all electricity suppliers to compete fairly. Non-discriminatory availability of service, including ancillary services, back-up power and interconnection services, should be assured for all firm service customer classes.

PUBLIC BENEFITS

The public benefits of energy efficiency, renewable resource technologies and research and development should be maintained through existing or new mechanisms.

Energy efficiency, renewable resource technologies and research and development provide significant economic and other benefits for the nation and are critical to achieving a long-term, sustainable and efficient electricity future.

Commentary

Competitive markets have the potential to reduce the total costs of electricity production in the country, to lower rates if benefits accrue to customers fairly, and to stimulate innovation

and new investment. Nevertheless, policy-makers should recognize that, in certain instances, barriers to efficient competition prevent market participants from correctly valuing the full costs and benefits of certain production and consumption decisions. Many aspects of utility regulation, and many utility practices, including integrated resource planning, have been developed to address these market barriers, and have delivered significant benefits to consumers and the nation.

The development of competitive markets can be consistent with the ultimate goals of traditional utility regulation. As the economics and technology of generation evolve, new products and services can be expected to proliferate in the market. This market evolution will depend in part on the availability of information, low transactional hurdles and the appropriate alignment of risks and rewards. However, for public policy reasons and because not all potential risks will be fully reflected in short-term market prices, it will be necessary for policy-makers to promote and implement mechanisms that will serve the long-term needs and aspirations of the nation. To the extent that cost-effective investments in energy efficiency, renewable resources, and research and development are not fully valued in the competitive marketplace, there will continue to be a need for alternative methods for capturing the benefits that they offer.

ENVIRONMENT

Structural changes to the electric industry should maintain or improve the quality of the environment.

The electric industry affects the environment, and environmental protection continues to be a high priority for society. The environmental benefits and costs of different generation, delivery and service options should be recognized through market mechanisms, where they are effective, or by regulation.

Commentary

The electric industry has profound impacts upon the environment. Under the principles of traditional utility regulation and, in particular, integrated resource planning, it has been possible for utilities and governments to pursue environmentally responsible development policies.

The invisible hand of the market is powerful, but the limitations of markets are real: external costs, by definition, are not accounted for by markets, competitive or otherwise. Historically, regulation of electricity generation and transmission offered a means of partially, if imperfectly, addressing external costs. Restructuring initiatives should be designed to maintain or improve society's ability to consider external costs when making resource and delivery decisions. There is a variety of mechanisms that policy-makers can consider in order to achieve this goal, and their ultimate choices will be guided by the particular needs of their States and regions.

STRANDED COSTS

Existing commitments of utilities arising from past decisions made pursuant to historical regulatory and legal principles should be addressed in a fair and reasonable manner by States.

Claims to recover net, verifiable and non-mitigable costs potentially "stranded" in a restructured market should be decided by States.

Commentary

In moving from traditional regulation to a market-based electricity supply system, some embedded utility costs will be above the market prices of presently available alternatives. Because the circumstances of how these cost commitments arose are unique to state decisions, the States should determine which costs are stranded and the degree to which and manner in which they should be recovered. The States are in the best position, because of their history of regulation of the electric utilities, to develop methods for verifying the legitimacy and magnitude of stranded costs and for assessing the adequacy and appropriateness of measures proposed for mitigating stranded costs.

In order to address these costs in a fair and reasonable manner, the States should equitably consider utility investors' reasonable expectations along with ratepayers' expectations of access to the benefits of restructuring. Because of the unique character of each electric utility's costs, financial condition, and customers, and the history and remaining lives of its physical and regulatory assets, only the States can tailor a fair solution to the extent and timing of recovery of any costs determined to be stranded.

STATE RESPONSIBILITIES

States and state commissions should determine retail electric policies, including restructuring policies.

Restructuring should recognize the unique characteristics of the various States. State legislatures and state public utility commissions are most accountable to the people and are closest to the people, problems and opportunities that restructuring will present at the retail level. Accordingly, the policy and implementation decisions related to retail electric service should be determined by the States.

Commentary

The restructuring of the electric utility industry cannot occur efficiently or reliably in a "one-size-fits-all" fashion. Although the electrons that flow to homes and businesses throughout the United States may, for all practical purposes, be indistinguishable, the method, quality and cost of providing electric service vary by state and region. For example, population density can affect availability, quality and cost of service.

Throughout the years, the States have taken into account the unique problems associated with the public they serve, and restructuring should be no different. In fact, during this time of

great change in the electric utility industry, States should have the opportunity to employ the expertise they have gained through the regulatory process to benefit the public. Allowing the States to determine the retail electric policy and implementation issues associated with restructuring insures that each state is responsible for choosing a path which best recognizes the unique problems and opportunities its citizens may experience.

Federal agencies and federal legislation should facilitate effective decision-making by the States, and empower States to create regional mechanisms to address transmission, reliability, market power, and other regional concerns.

LEHMAN BROTHERS

Electric Utilities

Jim Asselstine

Competition

Expectations for 1997

- Federal legislative issues
  - PUHCA/PURPA reform
  - Nuclear decommissioning cost recovery
  - Broader industry restructuring proposals

Competition

Expectations for 1997

- Substantial State legislative and administrative activity on competition
- By end of 1997, many of high-cost states will have established their framework for a competitive industry
- Expect continued convergence of state plans
  - Reasonable transition period of about 5 years
  - Opportunity for stranded cost recovery
  - Phase-in of retail competition
  - Wholesale competitive market
  - Independent System Operator for transmission
  - Use of securitized financing to accelerate CTC recovery

Competition

Expectations for 1997

- States with greatest activity likely to include:
  - Pennsylvania
  - New York
  - Illinois
  - New Jersey
  - Michigan
  - Connecticut
  - New Hampshire
  - Arizona
  - Possibly Texas and Ohio
- With a few possible exceptions, expect state frameworks to be balanced and reasonable

Competition

Summary of California Legislation

- Endorses/codifies key elements of CPUC's decisions
- Creates competitive auction market (Power Exchange)
- Requires centralized control of transmission grid by Independent System Operator
- Calls for a western regional compact to protect system reliability
- Directs phase-in of direct access, or retail competition, subject to implementation of non-bypassable Competition Transition Charge (CTC)

Competition

Summary of California Legislation

- Provides for accelerated recovery of broad range of transition costs
- Mandates rate freeze/10% rate reduction from January 1, 1998 through March 31, 2002
- Anticipates further rate reductions beginning April 1, 2002; target of minimum 20% reduction for residential, small commercial customers
- Strongly encourages utilities to sell fossil generation
- Provides financing mechanism to accelerate portion of CTC recovery

Stranded Cost Recovery and Securitization

- Utility Stranded Cost Recovery =

f[Current Rate Schedule vs. Transition Rate Schedule

+

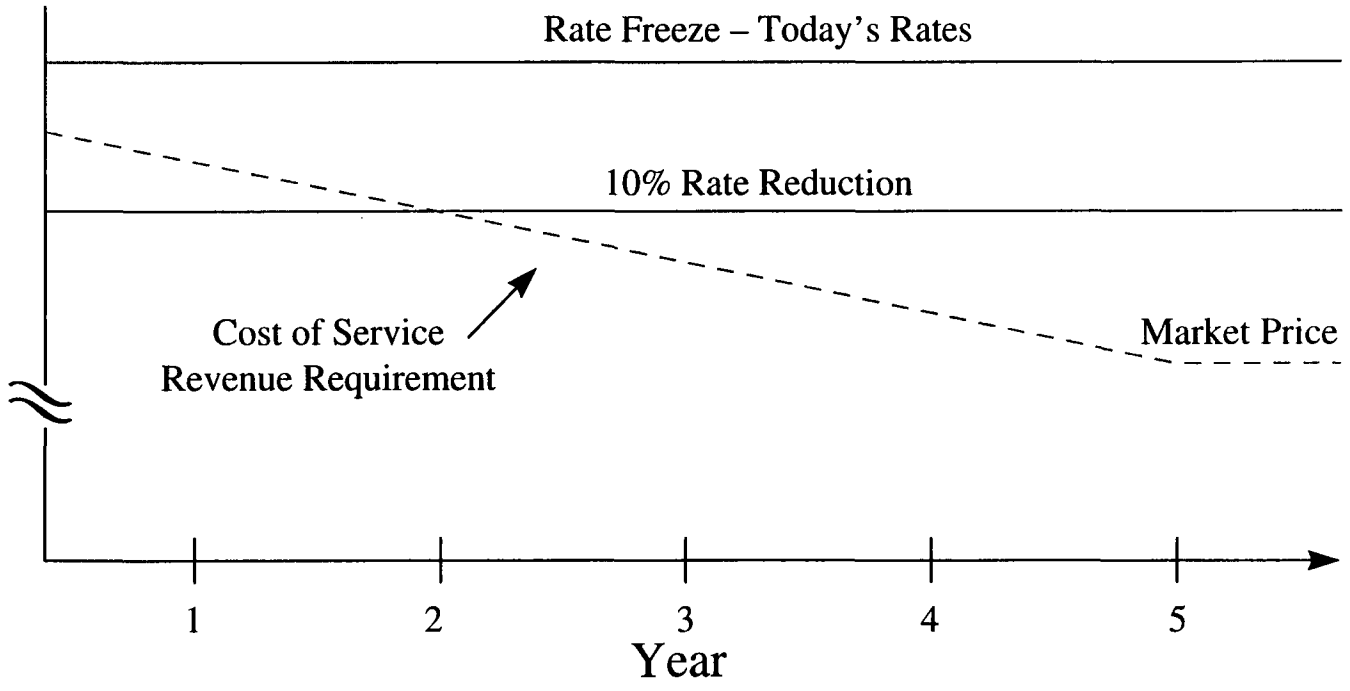
Securitization Effect (Depreciation/Amortization + Cost of Capital Savings)

+

Cost Reductions]

Stranded Cost Recovery and Securitization

California Model



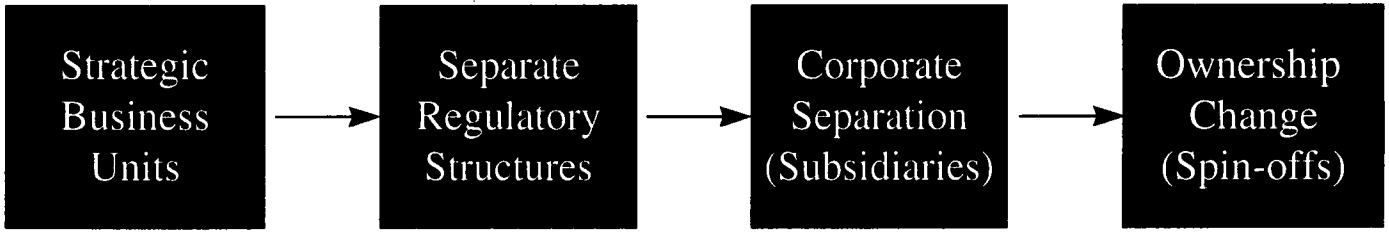
Stranded Cost Recovery and Securitization

- Benefits of Securitization Financing for Utilities
  - Acceleration of stranded cost recovery
  - Shifts uncertainties for recovery to the securitized financing
  - Permits financing of stranded costs over a longer time period
  - Provides for rate reduction "benefits"; helps to promote reasonable transition period
  - Use of proceeds to "shrink" the utility's capital structure provides savings
  - Financing should provide the utility with off-balance sheet accounting and credit rating treatment

Disaggregation

Extent of Change

Lesser → Greater



Credit Quality Impact

None	None	Potential Rating Difference	Potential Rating Difference

Disaggregation

Sale or Spin-off of Assets

- Most utilities continue to prefer functional unbundling or structured unbundling within holding company structure
- Market power concerns leading FERC/State regulators to encourage or require sale or spin-off of generation
- Utilities may agree to sell or spin-off generation in response to regulatory pressure or requirements, or out of necessity to achieve unregulated status for generation
- Examples of sale or spin-off of generation
  - California utilities
  - New England Electric System
  - Niagara Mohawk Power

Nuclear Issues

- Stranded cost recovery issues
- Cost-competitiveness of nuclear units
  - Large units; multi-unit plants
  - Small, single-unit plants
- Decommissioning costs
- NRC concerns regarding competition

STATEMENT OF
SUSAN TOMASKY, GENERAL COUNSEL
FEDERAL ENERGY REGULATORY COMMISSION

BEFORE THE

NUCLEAR REGULATORY COMMISSION
APRIL 24, 1997

Madam Chair and Members of the Commission,

I appreciate the opportunity to be here today to talk about the recent activities of the Federal Energy Regulatory Commission in the area of electric utility regulation.

The electricity industry is facing fundamental changes in the way it does business. We are moving toward an environment in which power will be priced in a competitive marketplace. The FERC believes very strongly in developing competitive markets for electricity. Toward that end we have initiated fundamental changes in our approach to utility regulation. These changes will encourage the development of competition in wholesale power markets and provide a fair and rational transition to a competitive wholesale marketplace.

This morning I want to describe recent FERC policy initiatives in four major areas:

- Requirements for open access transmission service;
- Recovery of stranded costs;
- Market based rates for wholesale sales of electricity; and
- Merger policy.

These are the essential elements of the Commission's pro-competition policies. In addition, I will touch briefly on other areas of particular concern to our Commission -- maintaining reliability of the nation's electricity delivery system and the evolving relationship between Federal and state regulators.

The centerpiece of the Commission's electricity policy initiatives is Order No. 888. In Order No. 888, the Commission required all "public utilities" under the Federal Power Act to file non-discriminatory open access transmission tariffs. Under these tariffs, the transmission owning public utility is required to provide "comparable" transmission service. Comparability assures that wholesale buyers and sellers of power can obtain transmission service on the same terms and conditions that would apply to the transmission owner. In other words, the transmission owning utility can no longer restrict access to its transmission system to favor its own generation.

In addition, public utilities are required prospectively to "unbundle" their wholesale transactions. This means that they must transact separately with their wholesale customers for power sales, transmission services and ancillary services.

To ensure that the tariffs work and that access to the transmission system is fair and not subject to manipulation, the Commission in Order No. 889 has also required public utilities to establish standards of conduct that separate their power marketing and transmission functions. A public utility is also required to have in place an internet accessible computer information system -- known as an "OASIS" -- so that prospective transmission customers will be able to know what transmission capacity is available and at what price.

Open access transmission is now a fact of life across the industry. Certainly, there are dozens of discrete issues that the Commission will continue to resolve in particular cases. Indeed, there are some very difficult and particularly important issues of regional significance that have yet to be resolved, including the restructuring of tight power pools. However, there is little dispute over the fundamental principle of open access. Most jurisdictional utilities have timely implemented their open access tariffs and are busy figuring out how to do business in an open access environment.

Nonetheless, there are some fairly significant holes in the open access map. Order No. 888 applies only to "public utilities" under the Federal Power Act. This leave a number of transmission owing utilities exempt from the generic open access requirements of Order No. 888. These are the publicly owned utilities, including municipally and most cooperatively owned utilities, the Federal Power Marketing agencies, and such significant transmission owners as the Tennessee Valley Authority and the Bonneville Power Administration. While we have attempted through various means to encourage these utilities to implement open access on their own, we have met with mixed success, at best. For that reason, the Chair of our Commission has called upon Congress to address this issue.

Let me turn now to another critical element of the Commission's open access policy, which is the treatment of stranded costs. In a competitive marketplace, traditional utility sellers ultimately must be able to compete on the same basis as other sellers and assume the same investment risk as other competing sellers. However, the Commission is well aware that in the past, utility investment decisions were made under different expectations. Typically, utility investment decisions were based upon the expectation of continuing to serve existing customers (and sometimes future load within a service territory) at cost based rates.

In the context of wholesale supply arrangements, these expectations could arise if a utility seller made planning and investment decisions based on a reasonable expectation of continuing to serve a contract requirements customer beyond the term of a contract. In the retail context, these expectations would typically arise when investments that were made to meet franchise obligations are no longer necessary to serve consumers who, under a state retail choice program, are purchasing power from other suppliers.

At both the federal and state level, rates were set based upon longstanding principles providing the utility the opportunity for recovery of all prudently incurred costs and a reasonable return on that investment. In a competitive marketplace, however, utilities are no longer

guaranteed that opportunity. Prudently incurred costs may be unrecoverable, that is, they may be stranded.

There is no question that the stranded costs issue -- the price tag for open access -- is the most hotly contested issue associated with Order No. 888. After considering thousands of pages of comments on this issue, the FERC has come down firmly on the side of allowing utilities an opportunity to seek stranded cost recovery.

In Order No. 888, the Commission stated that utilities should be given an opportunity to recover all verifiable and prudently incurred costs that are stranded when a customer departs a traditional utility supplier and uses that supplier's transmission system to access a new supplier. The Commission also indicated that it would serve as the primary forum for stranded costs disputes arising from the departure of a retail customer who becomes a wholesale buyer and takes transmission service under a FERC mandated open access tariff.

Under Order No. 888, the recovery of stranded costs from a particular customer will be determined on a case-by-case basis. The utility bears the burden of demonstrating that it had a reasonable expectation of continuing to serve the departing customer beyond the term of the contract. If the utility meets its burden, the customer's stranded costs obligation will be a share of the utility's projected revenue stream calculated under a formula set forth in Order No. 888.

The FERC clearly believes that we can have a fair transition to competition only if utilities are permitted the opportunity to recover costs reasonably incurred under a prior regulatory regime. However, the vast majority of stranded costs are likely to be generation costs incurred to serve retail load. The FERC has indicated that it will address retail stranded costs only if a state commission lacks authority to do so. The FERC has strongly encouraged state commissions to address this issue up front, as they proceed with retail choice programs. We hope that the states will follow the Commission's lead in providing a fair transition mechanism.

I now want to mention the FERC's policies governing market based rates for wholesale sales of electricity. For several years the Commission has been ruling on applications of wholesale sellers, including power marketers, to sell electric power at market based rates. Power marketers include both entities that are affiliated with traditional utilities and those that are not. In Order No. 888, the Commission confirmed an earlier generic finding that future, long term generation markets are competitive. We therefore permit sales from new generation to occur at market based rates, without a showing that the seller lacks generation market power.

For existing generation, however, we continue to believe that there is a significant risk that the seller can exercise generation market power. We do not authorize sales at market based rates unless we are satisfied that the seller lacks generation market power or its market power has been successfully mitigated.

We now have a large number of marketers, including marketers affiliated with public utilities, selling power at market based rates. Some of these sales are made from existing generation. We expect that this trend will continue and that, increasingly, as existing wholesale contracts expire, the price for wholesale electric energy will be set by the competitive marketplace.

I want now to describe briefly the Commission's recent actions in the area of merger policy. In December 1996, the Commission issued a Statement of Policy that will govern its future review of applications for approval of mergers involving public utilities under section 203 of the Federal Power Act. In the Merger Policy Statement the Commission identified three factors that it would consider in determining whether a proposed merger is in the public interest. These are: the effect of the merger on competition; its effect on regulation; and the existence of adequate ratepayer protection.

The Merger Policy Statement signals the Commission's concern with the potential effects of utility mergers on the growing competitive marketplace. The Policy Statement sets out in extensive detail an analytic screen, based on the Department of Justice/ Federal Trade Commission merger guidelines, for determining whether a proposed merger is likely to raise competitive concerns.

The Commission recognized that public utilities will reasonably look to mergers and consolidations as viable strategic options for responding to their rapidly changing business circumstances. The Commission does not generally wish to discourage such realignments. At the same time, mergers that reduce the number of sellers in a market tend to undermine the competitive conditions that the Commission is attempting to foster. The Merger Policy Statement is intended to reduce regulatory impediments, through expedited procedures, for mergers that do not raise competitive concerns and to encourage the development of market power remedies for mergers that do raise competitive concerns.

We fully expect that competition will bring significant benefits to consumers without jeopardizing the highly reliable electricity service we have historically enjoyed in this country. Maintaining reliability in a competitive environment does pose some new challenges. However we firmly believe that these challenges can and will be met.

We support the efforts of the North American Electric Reliability Council to take the lead on reliability issues. But the reliability rules-of-road are not well defined. NERC is working on that, but more needs to be done. Membership in NERC is not mandatory. And there are no effective enforcement programs for making sure everyone plays by the same rules--and for ensuring that all industry segment are involved in setting these rules. Reliability in a competitive environment is too important to be left to a voluntary regime.

FERC should have the authority to make compliance with NERC standards mandatory for all segments of the industry. We need the authority to resolve disputes and to impose penalties on those who violate reliability requirements.

Finally, I would like to mention a significant challenge still ahead: which is how to make the federal/state relationship work in meeting the challenges of electricity industry restructuring. The FERC well recognizes that our colleagues at the State commissions face enormous challenges in moving to the world of customer choice. If a state moves to retail access, a jurisdictional shift between federal and state regulation occurs with respect to transmission in interstate commerce. However, regulation of generation and retail sales issues remain in the hands of the states. States will therefore have the lead in fashioning retail choice programs and in resolving many of the extremely difficult issues raised by utility restructuring.

Various features of Order No. 888 are designed to accommodate the need for states to take the lead in designing retail customer choice programs. The FERC has stated its intent to exercise its own jurisdiction of unbundled retail transmission matters with deference to the views of state commissions. We believe we have made great progress in working with the states in addressing the complex issues we are all facing and fully expect our cooperative processes to continue.

I hope this presentation has been useful in providing an overview of recent policy initiatives at the FERC. I would be happy to try to answer your questions.

CORNERSTONES FOR RELIABILITY

PRESENTATION TO THE NUCLEAR REGULATORY COMMISSION

PHILLIP G. HARRIS

APRIL 24, 1997

PJM is the largest centrally dispatched control area in North America.

- 8.6 % OF U.S. POPULATION
- 7.9 % OF PEAK (48,524 MW)
- 7.7 % OF ENERGY (250 TWH)
- 7.8 % OF CAPABILITY (56,000 MW)

- 540 UNITS
- DIVERSE FUELS
- 8000 MILES EHV TRANSMISSION

- 5 STATES AND D.C.
- SEPARATE ENTITY SINCE 1993
- SINGLE NERC REGION
- COMPETITIVE PARTICIPANTS

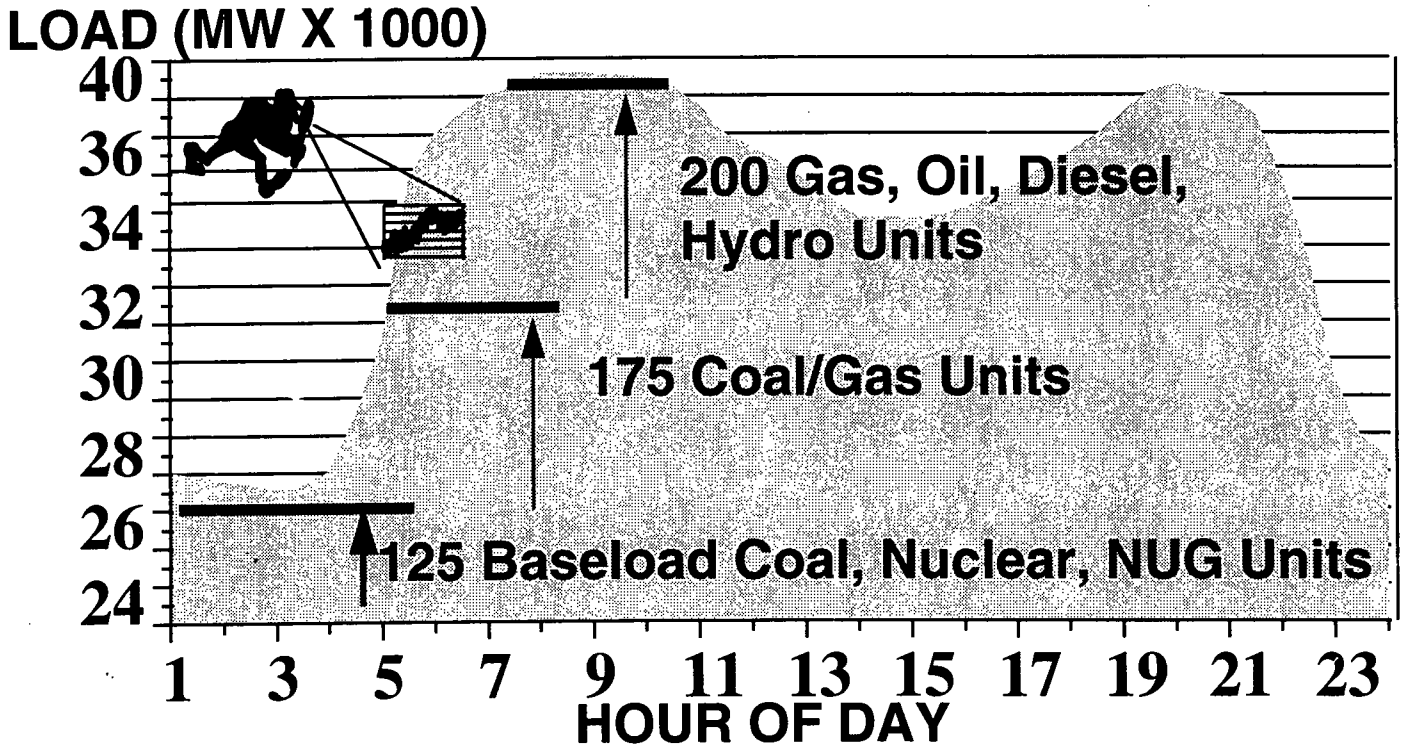
BENEFITS OF POOLING

- Reduced installed capacity requirement
- Shared transmission network
- Diversity of peak, seasonal load
- Diversity of generation mix
- Shared risk and reserve
- Centralized dynamic transmission network security and reliability management
- Coordination of generation/transmission maintenance scheduling

$100 MILLION CENTRALIZED DISPATCH SAVINGS

$1.2 BILLION NON-INTERCHANGE SAVINGS

DAILY LOAD SHAPE

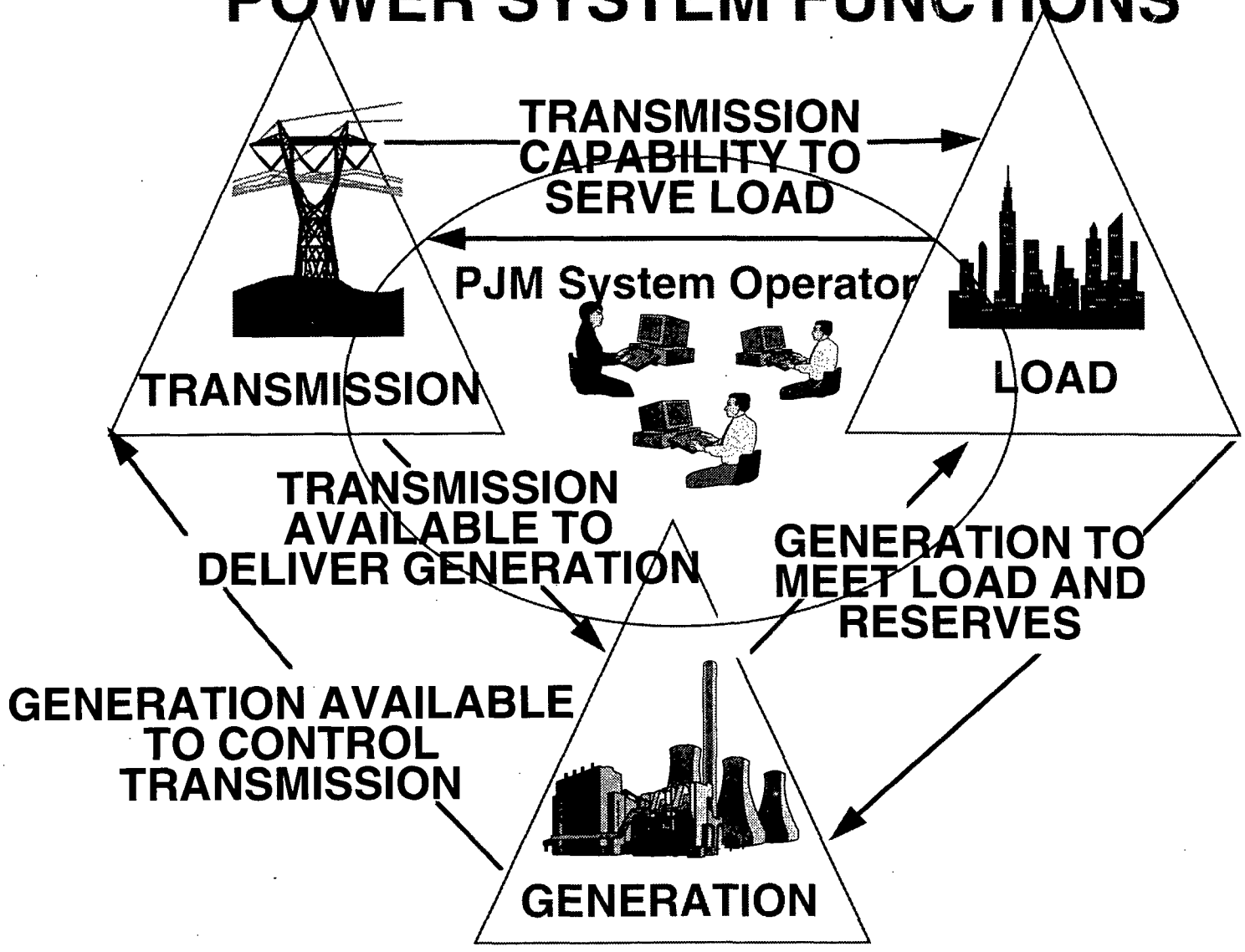


CALVERT CLIFFS 1&2
PEACH BOTTOM 2&3
SALEM 1&2
HOPE CREEK 1

PJM NUCLEAR UNITS
23% OF CAPACITY
35% OF ENERGY

OYSTER CREEK 1
TMI 1
SUSQUEHANNA 1&2
LIMERICK 1&2

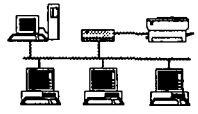
POWER SYSTEM FUNCTIONS



CORNERSTONES FOR RELIABLE RESTRUCTURING

- **CAPABILITY TO RELIABLY OPERATE THE GRID**
  IN A RAPIDLY CHANGING ENVIRONMENT

- **INFORMATION EXCHANGE**
  FOR MAINTAINING DYNAMIC SECURITY



- **AUTHORITY**
  TO TAKE STEPS TO MAINTAIN SECURITY

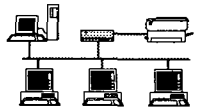
- **PREDICTABLE BEHAVIORS**
  SO OPERATING PLANS MATCH OPERATIONS

CAPABILITY TO RELIABLY OPERATE THE GRID

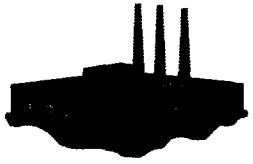
- PJM HAS OPERATED RELIABLY IN THE PAST AND WILL CONTINUE TO DO SO UNDER PROPOSED RESTRUCTURING PLANS
  - CAPABLE, SKILLED, EXPERIENCED PEOPLE
  - IN DEPTH TRAINING PROGRAMS

- THE PJM INFRASTRUCTURE PROVIDES THE APPROPRIATE SUPPORT TO MAINTAIN RELIABILITY
  - TELECOMMUNICATIONS, METERING
  - HARDWARE, SOFTWARE
  - PROCEDURES, EXPERIENCE

INFORMATION EXCHANGE



UNIT COMMITMENT



MARGINAL SCHEDULER

ENERGY MANAGEMENT SYSTEM

ACCOUNTING / AUDITING

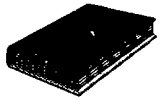
BEFORE THE FACT — REAL TIME — AFTER THE FACT

PLANNING STUDIES

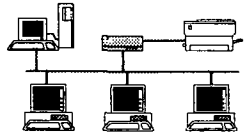
OASIS

TRANSACTION MANAGEMENT SYSTEM

REPORTS

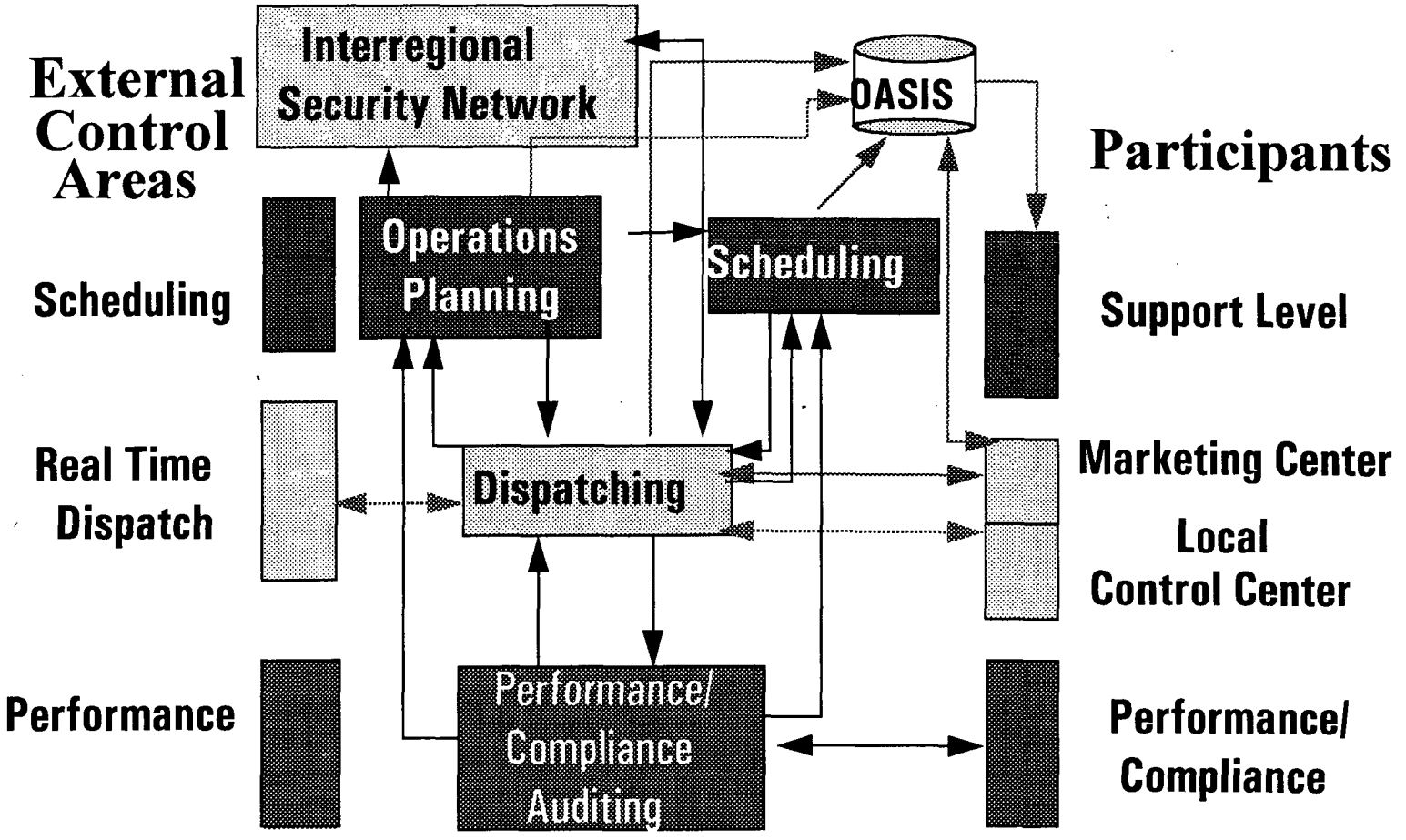


INTRA/INTERREGIONAL COMMUNICATION



OUTAGE INFORMATION

ISO FUNCTIONS



AUTHORITY

- PJM SYSTEM OPERATOR HAS ABILITY TO IMPLEMENT PROCEDURES NECESSARY TO PRESERVE RELIABILITY, INCLUDING DISCONNECTING FIRM LOAD
- PJM AND MAAC CONTRACTS / AGREEMENTS OBLIGATE PARTICIPANTS TO MEET NERC AND REGIONAL RELIABILITY POLICIES
- NERC IS DEVELOPING ADDITIONAL OPERATING AND PLANNING STANDARDS WITH WHICH PJM PARTICIPANTS WILL BE EXPECTED TO COMPLY

PREDICTABLE BEHAVIORS

- PJM SYSTEM OPERATOR DEALS DIRECTLY WITH, AND ORCHESTRATES THE CONTROL OF MANY INTERRELATED ELECTRICAL SYSTEMS AND OPERATING PROCEDURES
- PARTICIPANTS RESPOND TO DIRECTIVES AND CONTROL SIGNALS
- INCENTIVES AND SANCTIONS ARE BEING DEVELOPED (ANCILLARY SERVICES)

CORNERSTONES FOR RELIABILITY