UNIVERSITY OF VIRGINIA
DEPARTMENT OF ECONOMICS
CHARLOTTESVILLE, VIRGINIA
22901

ROUSS HALL

(9)

September 11, 1981

Secretary of the Commission
U. S. Nuclear Regulatory Commission
Washington, D.C. 20555

DOCKET NUMBER
PROPOSED RULE PR-50
(46 FR 41786)

Dear Mr. Secretary:

I am writing to comment on your Federal Register notice of August 18, 1981, "Financial Qualifications; Domestic Licensing of Production and Utilization Facilities" (46 FR 41786). To summarize my comment, the proposed rule should not be adopted in its present form because:

(1) It is based on an inadequate understanding of passing-on of compliance costs by electric utilities, and

(2) It appears to foreclose an option to be studied by the NRC under the Action Plan for responding to the Three Mile Island accident.

The proposed rule would eliminate much of the financial qualifications review for electric utilities building nuclear power plants. Page 1 of the value/impact analysis accompanying the proposed rule states that:

> The proposed rule is grounded, to a large extent, on the ability of electric utility applicants to recover construction and operation costs through the economic regulatory process, or through their ability to set their own rates. The Commission believes that the ability to set one's own rates for an essential public service such as furnishing electricity permits those electric utilities to ensure recovery of all costs of construction and operation in a fashion similar to the rate-regulated utility.

The contention is that utilities can pass along nuclear safety compliance costs and therefore will not have financial reasons to skimp on safety. This reflects an inadequate understanding of how increased costs are passed along. In general, such a pass-on of costs will affect the utility's rate of return. Analysts have long recognized that a pass-on of costs could raise or lower rate of return, and the conditions that determine the effects of a pass-on

D510
S/1 Add: Jim Petersen
AR-2016

of costs are fairly well-known (see reference 1). The proposed rule and statement offer no evidence of awareness of these principles. The proposed rule and statement certainly offer no evidence that conditions are favorable for a passing on of costs without depressing rates of return in the cases at hand.

Even if electric utilities knew that regulators would adjust their rates to leave profitability unaffected in face of nuclear safety expenses, such adjustment would not be instantaneous. The presence of "regulatory lag" might well mean a temporarily depressed rate of return. Therefore the presumption that regulated electric utilities will not skimp on costly nuclear safety for financial reasons is not well-founded.

As for utilities that set their own rates, it is again naive to assume a complete pass-through of costs. It is an elementary proposition of economics that even a profit-maximizing monopolist with no competition cannot pass along increased compliance costs fully (see reference 2). Note also that such utilities face considerable political pressure to keep rates down even though they have the authority to set their own rates. Further, the use of the phrase "the ability to set one's own rates for an essential public service" implies an insensitivity of electricity demand to price that simply is not borne out in empirical studies, especially long-run studies.

Therefore there are sound a priori reasons to believe that electric utilities cannot in all cases fully pass along the costs of complying with nuclear safety directives. The proposed rule and statement offer no empirical evidence to contradict this a priori reasoning. Indeed, the rule and statement offer no evidence that the NRC has systematically studied the relationship between achieved safety and the operating utility's financial health. If such studies have been done, they belong in the justification for the proposed rule.

In addition to being poorly grounded, the proposed rule conflicts with the Commission's stated intent in the TMI Action Plan (see reference 3). The Commission proposed to study the Price-Anderson Act's limitation of liability for nuclear accidents to levels far below the potential damages. Obvious changes in Price-Anderson would include raising the liability level and making the nuclear utility more directly responsible for the liability that it faces. There are good reasons to raise the existing level of liability (see reference 4). Note, however, that an increase in the self-insured liability of nuclear operators could be defeated if financially unqualified utilities were allowed to build nuclear plants. In the event of a serious accident, instead of paying some self-insured claims the financially unqualified utility might simply declare bankruptcy. Thus the function of increased liability under Price-Anderson might be defeated by dropping financial qualifications as proposed. It is my understanding that study of the options on Price-Anderson is continuing; it would seem premature to adopt the proposed rule and foreclose options at this stage.

Thank you for the opportunity to comment on the proposed rule.

Yours sincerely,

William C. Wood

William C. Wood
Assistant Professor of Economics

REFERENCES

1. Fred M. Westfield, "Regulation and Conspiracy," American Economic Review, Vol. 55, No. 3 (June 1965), pp. 424-443.

2. William J. Baumol and Alan S. Blinder, Economics: Principles and Policy (New York: Harcourt Brace Jovanovich, Inc., 1979), pp. 443-444.

3. U. S. Nuclear Regulatory Commission, "NRC Action Plan Developed as a Result of the TMI-2 Accident" (NUREG-0660), May 1980, p. V-5.

4. William C. Wood, "Nuclear Liability After Three Mile Island," forthcoming, The Journal of Risk and Insurance (copy enclosed).

WCW/ppc

Enclosure