

STATE OF NEW YORK  
PUBLIC SERVICE COMMISSION

OPINION NO. 98-7

CASE 94-E-0952 - In the Matter of Competitive Opportunities  
Regarding Electric Service

CASE 98-E-0405 - In the Matter of Nuclear Generation in a  
Competitive Market for Electricity, filed in  
Case 93-M-0229.

OPINION AND ORDER INSTITUTING  
FURTHER INQUIRY

Issued and Effective: March 20, 1998

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COMMISSIONERS:

John F. O'Mara, Chairman  
Maureen O. Helmer  
Thomas J. Dunleavy

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BY THE COMMISSION:

INTRODUCTION

By notice issued August 27, 1997, we invited comments and reply comments on a "Staff Report on Nuclear Generation" (Staff Report), in which Staff had set forth its tentative conclusions regarding the treatment of nuclear generation following the transition to a competitive electric market. In general, Staff favored subjecting nuclear power to the same market forces that would apply to electricity produced from other sources.

Twenty-two parties filed comments and seven filed replies; they are listed in the Appendix together with the short designations used in this opinion.<sup>1</sup> The comments ranged from warm endorsement of Staff's recommendations and calls for their implementation even sooner than Staff had contemplated to condemnation of the proposals as ill-considered, ill-advised, impracticable, or counter-productive. Our review of the

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<sup>1</sup> In addition, one party, under the impression that this inquiry extended to fossil generation as well, filed separate comments on fossil fuel issues.

comments<sup>1</sup> suggests a need for further inquiry regarding Staff's proposals, and, in this opinion and order, we direct the institution of that inquiry.

#### BACKGROUND

Consistent with our Competitive Opportunities decision (the COB Decision),<sup>2</sup> five of the six investor-owned utilities with nuclear investment<sup>3</sup> have entered into settlement agreements, four of which we have approved,<sup>4</sup> calling for the eventual divestiture (to third parties) or transfer (to non-regulated affiliates) of their generation facilities. Some of these agreements, however, suggest that nuclear plants may remain subject to a more traditional regulatory regime, in the hands of the regulated utility, which would otherwise be engaged only in transmission and distribution (T&D) of electricity. The Staff Report presents tentative conclusions on the policy issues thereby raised.

Six nuclear generating plants now operate in New York State; in 1996, they accounted for almost one fourth of the State's electric generation. Two of the plants, with total capacity of about 1,780 MW, are owned by the New York Power Authority (NYPA). The remaining four, with total capacity of about 3,210 MW, are owned by investor-owned electric utilities.

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<sup>1</sup> In describing the comments, we have not reported every opinion in the name of every party expressing it. Accordingly, listings of parties making particular points should not be seen as exhaustive, though all parties' comments have been fully considered.

<sup>2</sup> Cases 94-E-0952 et al., Opinion No. 96-12 (issued May 20, 1996).

<sup>3</sup> Of the seven investor-owned combination gas and electric utilities in the State, only Orange and Rockland Utilities Inc. owns no nuclear facilities. LILCO has not been involved in the COB settlement process.

<sup>4</sup> The fifth, Niagara Mohawk Power Corporation's, has been before us for action, and issuance of our opinion and order is pending.

The existing Nuclear Regulatory Commission licenses for these facilities will expire between 2009 and 2026.

According to Joint Utilities, the remaining undepreciated net book investment of the four non-NYPA plants is about \$5.3 billion. Approximately 4,300 individuals are employed in the operation of nuclear power plants, and more are involved in their management and supervision. Joint Utilities assert that

continuing operation of these facilities through the end of [their license] terms . . . is expected to avoid significant reliance on fossil-fueled generation and consequent production of greenhouse gasses, while, at the same time retaining employment and local tax revenues from investor-owned facility property taxes.<sup>1</sup>

Whether and how to take account of these factors are among the matters disputed by the commentators. More broadly, the fundamental question is whether nuclear facilities possess special attributes, be they positive (such as enhancement of fuel diversity, low running costs, and reduced air emissions) or negative (such as safety concerns, high initial costs, and operational constraints), that warrant treating them differently from other generation sources.

#### THE STAFF REPORT

After examining its particular qualities, Staff concluded, taking account of the COB Decision but contrary to the implications of some of the settlements, that subjecting nuclear generation to the market would benefit customers without jeopardizing safety. It found that nuclear plants, like others, should be run only when their on-going costs would be covered by the market price of electricity; and that nuclear plants, like others, should be sold at auction, to unaffiliated interests, in order to secure the highest possible value for the assets and

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<sup>1</sup> Joint Utilities' comments, p. 2.

thereby mitigate the amount of investment above market value ("stranded costs") that ratepayers would otherwise be required to pay through wires charges to the surviving T&D utilities. Recognizing that the sale of at least some nuclear facilities might prove impractical, Staff proposed as well an "administrative" alternative, under which recovery of "to go" nuclear costs would be limited to the wholesale price of electricity, and recovery of sunk costs would be subject to Commission review.

More specifically, the Staff Report offered the following observations and conclusions:

- no administrative pricing scheme can be as effective as the free market in providing proper pricing signals, and the free market will be more efficient if owners of T&D facilities have no financial interest in generation
- existing generating plants (including nuclear) should be operated only if their running costs (i.e., costs that can be avoided if the plant is permanently shut down) do not exceed the wholesale market price of electricity
- fuel diversity and environmental concerns should be addressed through the market, and the contributions of nuclear power to enhanced fuel diversity and reduced air pollutant emissions should be reflected in the price offered for a nuclear unit
- prudently incurred nuclear decommissioning costs should remain the responsibility of the surviving T&D utilities and their ratepayers even after the nuclear plants are transferred to third parties; doing so will ensure the availability of adequate decommissioning funding, and the cost of decommissioning will not be significantly affected by the new owner's continued operation of the plant
- nuclear safety will remain the province of NRC regulation and enforcement and thereby continue to be adequately addressed; economic incentives to unsafe operation will be no greater under market pricing than under cost-of-service regulation, which tied recovery of sunk investment to continued operation

- selling nuclear plants to third parties via auction (in which sale prices reflect expectations not only of operating costs and market prices but also fuel diversity, environmental costs and benefits, and operating risk) provides the best way to determine and maximize the plants' market value, thereby both measuring and mitigating stranded costs
- selling nuclear plants to third parties via auction likewise removes the potential for market-distorting cross-subsidies of generation by affiliated T&D interests

Staff would introduce this market pricing regime following a transition period extending, pursuant to the settlements, until roughly 2002. (During that transition, nuclear costs will be recovered within the price caps established by the settlements.) The transition period would allow utilities to prepare for the auction and associated changes, and would likewise permit municipalities to prepare for the tax consequences of the new arrangements.

Finally, the Staff Report recognizes that some nuclear units, especially those with short remaining service lives, may be unmarketable even if the purchaser incurs no responsibility for decommissioning and spent fuel costs. In that event, Staff would propose an alternative "administrative" regime under which "to go" nuclear costs, including prospective capital additions and property taxes, could be recovered only to the extent they did not exceed the wholesale market price of power. Efficient plants would thus continue to operate; others would close unless the owner thought it worthwhile to absorb short-term losses for the sake of future gain. Recovery of sunk costs would be subject to our review, and, in that context, we could consider mitigation measures taken by the utility, including steps to promote competition in its service area.

#### OVERVIEW OF COMMENTS

With the exception of NYSEG, all utilities and utility groups (including NYPA) oppose Staff's proposal, generally

contending that it fails to recognize adequately the special qualities (both positive and negative) of nuclear power. The Utility Workers, PULP, and Multiple Intervenors take positions similar to those; Multiple Intervenors does not dismiss Staff's proposal as forcefully as some other parties but stresses the need for further study of alternatives. Oswego adds the perspective of a municipality concerned about losing the tax revenues derived from nuclear plants.

The foregoing parties are joined in their challenges to Staff's proposal by three parties that disfavor or at least seriously question nuclear power. Mr. Straka, NYPIRG, and WNY Environmentalists suggest Staff is too accommodating of nuclear generation. Mr. Straka warns of a "bailout" that permits recovery of all stranded costs; he asks us to stop recovery of any stranded costs as soon as the transition phase ends. WNY Environmentalists urge that all nuclear plants be closed immediately; it maintains that nuclear power "has never been a product for any marketplace" and that "it is a by-product of nuclear weapons production," subsidized by ordinary citizens, sold to a captive market, and benefitting a few large investors<sup>1</sup>.

The parties generally favoring Staff's proposal or offering qualified support include NYSEG, various independent power producer (IPP) interests, state agencies other than NYPA, and several environmental groups. Several of these urge that Staff's proposal be carried out immediately, rather than after the transition period; others would modify or condition the proposal somewhat in order, among other things, to ensure effective, safe, and relatively low-cost decommissioning.

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<sup>1</sup> WNY Environmentalists' comments, p. 1.

PROCESS ISSUES

Comments

Several parties opposed to Staff's position contend that it is inadequately supported and that the issues in the case cannot be decided simply on the basis of written comments. Joint Utilities, for example, maintain that "the future of nuclear generation in the State of New York is far too important an issue to be resolved on the basis of an unsupported summary report and comments and reply comments of unknown, untested quality."<sup>1</sup> Noting the availability of ample time before the end of the transition period, Joint Utilities urge us to convene collaborative technical conferences on these issues, in which representatives of the NRC would be invited to participate. Ensuing procedures would depend on the progress made at the conferences. NYPA also contends the issues raised by the Staff Report require further analysis before being presented to us.

PULP and Multiple Intervenors, among others, call for more extensive consideration of alternative courses of action; PULP asserts that Staff's proposal to auction off nuclear plants while leaving the present owners responsible for decommissioning costs "rests on several unsubstantiated assumptions and ignores basic economic principles."<sup>2</sup> The Utility Workers, expressing surprise that we would even consider acting on so important a matter on the basis of a nine-page report that assertedly provides no analysis of important issues, would have the utilities file financial plans for their nuclear units, including descriptions of how any plant closures would affect market prices and adequacy of supply and how adequate staffing and safe operation would be ensured for plants that remained open. Oswego urges preparation of a detailed Staff report on tax assessment practices with regard to utility properties and on related taxation issues.

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<sup>1</sup> Joint Utilities' comments, p. 5.

<sup>2</sup> PULP's comments, p. 2.

Central Hudson challenges the legal grounding of Staff's proposal, seeing no statutory basis for forced divestiture. It contends that its investment in generating plant (nuclear and fossil alike) has been found prudent and that we are obligated to provide its investors "a reasonable opportunity to recover both their capital investments and to receive a rate of return commensurate with the risks involved during the time until their investments have been fully recovered."<sup>1</sup> It sees no theoretical or empirical analysis that provides a basis for Staff's conclusion that divestiture is the best way to mitigate stranded costs and preclude anti-competitive subsidies, nor any consideration of how the price to be paid for a plant will be affected by the allocation of risks between buyer and seller.

From the opposing perspective, the Pace Energy Project urges a generic proceeding on decommissioning, and the Sierra Club and NYPIRG see a need for an Environmental Impact Statement (EIS) with respect to Staff's proposal. WNY Environmentalists emphasize that our process must be open.

In reply comments, supporters of Staff's proposal generally do not oppose further inquiry and proceedings. Most prominently, IPPNY commends Staff for not regarding novel issues as insurmountable obstacles, but it concedes that "no one is suggesting that the nine-page Staff Proposal is detailed enough to be immediately implemented in full, without further discussions,"<sup>2</sup> and it sees the further inquiry called for by other parties as part of the process for carrying out Staff's proposal. It suggests endorsing Staff's policy findings and recommendations and then beginning an implementation process that includes a collaborative phase (guided by an Administrative Law Judge and with NRC participation), litigation if necessary, a recommended decision to be issued no later than January 1, 1999, and an opportunity for at least one round of exceptions. IPPNY

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<sup>1</sup> Central Hudson's comments, p. 3.

<sup>2</sup> IPPNY's reply comments, p. 5.

expresses confidence that if the process shows Staff's proposal to be unworkable, Staff will withdraw it. NRDC urges an environmental review, under the State Environmental Quality Review Act, that considers the pros and cons of nuclear plants and their alternatives.

Opponents of Staff also reiterate calls for further proceedings. Multiple Intervenors sees no basis now for adopting either Staff's proposal or any other and advocates a more comprehensive examination of auctions and alternatives alike. It nevertheless agrees with Staff that we should consider the exposure of nuclear assets to the emerging competitive markets, and it therefore would reject what it sees as the Utility Workers' and Oswego's advocacy of the status quo. It adds that the tax issues raised by Oswego are for the Legislature to deal with, and it objects as well to consideration in the further proceeding of Pace's proposal to internalize environmental costs. Joint Utilities renew their call for a collaborative process, noting the diverse group of parties seeing a need for further inquiry.

### Discussion

The Staff Report starts from the premise that our commitment to a competitive market place for electricity should have universal application, recognizes the existence of factors that might warrant tempering that commitment with regard to nuclear-fueled electricity, and concludes that those factors do not so warrant. But while Staff's conclusion with regard to market pricing is consistent with our overall commitment to a competitive market for electricity (and warrants considerable deference on that account), it cannot be adopted without further inquiry into the questions described later in this opinion and order. Staff's conclusion regarding divestiture, meanwhile, poses still more questions and requires further development and study (though we can say now that divestiture, even if ultimately required, would not be mandated before the end of the transition period).

Accordingly, we will institute a proceeding to examine the various issues identified in the remainder of this opinion and others related to them. The proceeding should begin with a collaborative phase, including technical conferences where appropriate and participation by representatives of the NRC to the extent it can be arranged. With the help of the Administrative Law Judge and Staff, interested parties would attempt to reach agreement where possible and would identify any issues that might warrant formal litigation.

Meanwhile, the utilities owning nuclear plants, after consulting with Staff regarding their content and timing, should draft Environmental Assessment Forms (EAFs) with respect to the actions being reviewed here. Comments on the EAFs would be invited, and they, too, might identify issues warranting further environmental review.

Once the issues requiring resolution were identified, a decision could be reached on the need, if any, for evidentiary hearings.<sup>1</sup> The targeted date for concluding the proceeding and resolving all issues should be six to nine months after the anticipated independent system operator (ISO) entity is started; we expect that some aspects of the inquiry may not be ripe for examination until the ISO is in place and the new power markets have begun to develop. In no event, however, should that final decision date be later than the second quarter of 1999. Beyond this guidance, we leave the detailed structure and schedule for the proceeding to the Administrative Law Judge.

#### MARKET TREATMENT FOR NUCLEAR POWER

##### Comments

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<sup>1</sup> This process resembles that called for by IPPNY, though it would neither make the initial policy judgments in favor of the Staff Report that IPPNY urges nor adopt IPPNY's detailed schedule. The need for further inquiry, to which IPPNY aptly refers, is great enough to preclude policy judgments at this time; and the specific nature and schedule of the further inquiry will depend on the issues identified through the collaboration.

Staff's proposal rests on the judgment that nuclear power, notwithstanding its peculiar features, can be subjected to the competitive market to the same degree as power from other generation sources. Parties supporting Staff's proposal, such as the AG and NRDC, therefore argue in general that all power, whatever its source, should be subjected to the discipline of the market place and that all generating stations should be run only when their on-going costs can be recovered through market prices. CPB agrees that markets provide more accurate price signals than regulation and that customers are in the best position to decide the premium to be paid for diverse fuel sources; to permit them to do so, however, it would introduce a system of "energy product labeling (environmental disclosure)" for all electric generation<sup>1</sup>.

Though it, too, supports Staff, Pace sounds a cautionary note with regard to safety, expressing concern, contrary to Staff's optimism on the point, that "safety may be compromised in a market environment in which short-term cost considerations dominate."<sup>2</sup> It sees a need for intensified NRC oversight and urges Staff to convey concerns on this account to the NRC. Pace also questions Staff's confidence that fuel diversity and environmental protection can be adequately secured through the market, noting, among other things, that the market strategies used by sophisticated customers to ensure supply and mitigate the risk of price volatility do little to promote commercialization of new technologies. Sierra Club, which also favors subjecting nuclear power to the marketplace, strongly denies that the market can resolve environmental concerns, and sees a need to study and internalize the externalities of nuclear power and to prepare an EIS on Staff's proposal.

Parties taking a view contrary to Staff's, including the Utility Workers, various utilities, PULP, and Oswego,

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<sup>1</sup> CPB's comments, p. 11.

<sup>2</sup> Pace's comments, p. 4.

question whether nuclear power can, in fact, be traded on the market. Suggesting that nuclear plants should always be regarded as base-load, "must-run" units, they point, among other things, to their low running costs and the difficulties of starting and stopping them in response to short-term price fluctuations. LILCO asserts that nuclear units are an "energy insurance policy," that government encouraged their development, and that they were "then designed and constructed based on operating assumptions that do not exist in the competitive market."<sup>1</sup> LILCO adds that the ability of nuclear energy to compete in the market is further compromised by its not enjoying the pricing credits to which it should be entitled for its contribution to reduced air pollution (a point raised by Con Edison as well) and that coal plants would be of little value if they were required to be fitted with the equipment needed to reduce pollutant emissions to the level of nuclear plants.

Central Hudson expresses concern about the absence of any analysis of how market pricing will affect the special safety requirements of nuclear power; WNY Environmentalists similarly warn (from a very different perspective, favoring closure of all nuclear plants) that the financial pressures of the market will compromise safety. Joint Utilities develop these positions more extensively, charging that Staff ignored the impediments, previously identified in various documents, to nuclear plants being operated in a competitive market. They cite, as an example, RG&E's restructuring plan,<sup>2</sup> which noted the following distinguishing features of nuclear plants:

their design, size, and complexity ill-suited them to frequent starts, stops, or power level changes;

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<sup>1</sup> LILCO's comments, pp. 4, 5.

<sup>2</sup> In Opinion No. 96-12, issued in this proceeding on May 20, 1996, we required all electric utilities except Niagara Mohawk and LILCO to file rate/restructuring plans by October 1, 1996.

because they are not easily mothballed, shutdowns in response to competitive operation are likely to result in permanent closure;

their high fixed costs and low fuel costs cause their capacity factors to have a disproportionate effect on their unit costs;

high fixed production costs, long-term financial commitments, and the need to respond promptly to NRC directives require a steady revenue stream; and

the paramount importance of safety means that operators must be able to make decisions solely on the basis of safety factors, without regard to market considerations.

The Utility Workers and PULP note, in this regard, that the purchase price of the plant will be a sunk cost for the operator, imposing pressure to operate the plant even in the face of safety hazards. Citing Staff's recognition of this concern and its consequent interest in breaking the tie between sunk cost recovery and plant operation, the Utility Workers charge Staff with "ignor[ing] the obvious, which is that a system which does not provide for sunk cost recovery is likely to create enormous pressure to continue to operate nuclear facilities at an absolutely low cost, with significant disregard for safety concerns."<sup>1</sup> Oswego cites NRC statements that it takes as evidencing concern about the effect of competitive markets on nuclear safety.<sup>2</sup>

In response, IPPNY, reiterating its view that all generation should be subject to the market, recognizes that nuclear plants cannot readily be cycled off and on in response to market prices but asserts that the market-based decision is whether a nuclear plant should be operated at all (in which case it should be run flat out) or should be retired. To the

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<sup>1</sup> Utility Workers' comments, p. 7, citing the Staff Report, p. 5.

<sup>2</sup> Oswego's comments, pp. 10-12.

utilities' concerns about air quality, it responds that anticipated regulations will cap and establish market-based trading schemes for two pollutants associated with fossil plants, and that the costs of emitting those pollutants will be internalized in generation dispatch decisions, to the advantage of nuclear power. (It also charges that the utilities' concern about environmental matters here clashes with their asserted unwillingness to recognize the environmental advantages of IPPs and demand-side measures.) Nor does IPPNY see any risk that health and safety would be jeopardized by financial pressures resulting from the Staff proposal. It cites the excellent safety record of nuclear naval vessels, achieved despite performance pressures more intense than those created by economics, and it suggests that only "a suicidal nuclear engineer" would operate a reactor beyond safe limits.<sup>1</sup>

NRDC similarly sees no need to treat nuclear power differently on account of its operating characteristics, noting that many renewables also have high start-up costs, low operating costs, and special scheduling requirements. It recognizes that the modularity of renewables reduces the scale of these concerns but believes they can be dealt with in all instances by a truly non-discriminatory ISO.

### Discussion

Some parties question the ability of the market to deal effectively with the unique scheduling requirements of nuclear facilities, but others point to analogous requirements associated with other technologies. Though the matter may warrant further inquiry, it is not clear that nuclear energy is unique in this regard.

More complex questions are posed with respect to the market's ability to properly account for various other qualities, both positive and negative, of nuclear power. By its nature, nuclear power requires special attention to safety; and,

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<sup>1</sup> IPPNY's reply comments, p. 14, n. 15.

regardless of whether the operator is a utility or some other entity, we must examine the possibility that the need to compete in the market could augment counter-incentives to safe operation. NRC regulations, to be sure, would remain the primary protection; the NRC itself has issued a document recognizing the safety issues posed by economic deregulation but expressing confidence that "economic deregulation does not preclude adequate protection of the public health and safety"<sup>1</sup>; and the safety record of the nuclear navy in the face of powerful operational pressures offers some additional reassurance, notwithstanding the distinctions between the military and civilian contexts. But we cannot dismiss out of hand the concerns about safe operation that the marketplace might create.

At the other end of the spectrum are the positive attributes of nuclear power, including increased diversity and reliability and improved air quality. Air quality, like safety, is subject to protection via regulation; beyond that, it may lend itself to recognition in market prices via trading schemes for pollutants, as IPPNY suggests. How any such mechanisms might be applied to nuclear generation, as well as other environmental questions (including those posed by the possibility of nuclear plants being closed prematurely, a matter discussed further in the next section), are matters warranting further inquiry. Similarly, the fuel diversity and reliability implications of market-priced nuclear power need further study. Staff is confident about leaving to consumers, in a functioning market, the needed judgments about the degree of diversity and reliability (and, perhaps, the environmental benefits) they are willing to pay for. That view reflects sound theory, and it becomes more practicable if one assumes that many of these judgments will be made not only by end-use consumers themselves but by the more sophisticated entities (primarily energy service

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<sup>1</sup> Nuclear Regulatory Commission, Final Policy Statement on the Restructuring and Economic Deregulation of the Electric Utility Industry, 62 Fed. Reg. 44071, 44072 (August 19, 1997).

companies) who will purchase energy on the basis of their assessments of the market; staff aptly cites in this regard the dual-fuel customers who routinely make judgments about how much reliability they want to pay for. But the all-or-nothing nature of the commitment to nuclear energy, and the possibility that it may warrant special treatment as a diversity "insurance policy," are matters that require further examination before any decision is reached to subject it fully to the marketplace.<sup>1</sup>

All of these matters, encompassing both whether nuclear power should be subjected to the market place and, assuming a positive answer, how to go about doing so, should be examined in the inquiry we are instituting. Our final decision will be illuminated by the results of that inquiry, and it should not (nor could it) be anticipated now. But to guide the parties (and the Administrative Law Judge, should the matter be litigated), we note that market-based pricing of nuclear power is consistent in concept with our general policies regarding competition in the electric industry. Our identification of issues that need further study before the proposal could be adopted and carried out does not detract from its presumptive validity; and while the presumption may be rebutted, parties seeking to do so will bear a heavy burden of persuasion.

#### THE OWNERSHIP OF NUCLEAR POWER PLANTS

The Staff Report contemplates, as the favored outcome, an auction of nuclear power plants that would result in their purchase by third parties unrelated to the selling utilities. The comments raise several areas of concern regarding that

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<sup>1</sup> We recognize, of course, that the diversity benefits of nuclear power would be comparatively short-lived if the State's nuclear power plants were retired at the conclusion of their respective license terms. As described in the next section, those license terms, unless extended, imply that the diversity benefits would continue for only some ten years beyond the transition period; thereafter, nuclear plants would account for no more than 5% of the State's generating capacity.

process. To begin, some parties see insurmountable impediments to successful auctions; among other things, they question the existence of an adequate market for nuclear power plants. Beyond that, some comments see the consequences of any sale as unacceptable, because the new owners might close the plants improvidently or operate them in a manner contrary to the public interest with regard to safety or economics. The comments on these various aspects of the issue are presented under separate headings and are followed by a single discussion.

### Comments

#### 1. The Market for Nuclear Generating Plants

Opponents of Staff's proposal call into question the feasibility of selling nuclear plants at auction or otherwise and the likelihood that such sales could be an effective way of mitigating stranded costs<sup>1</sup>; they note, among other things, Staff's own recognition that any such sale would be unprecedented in the United States. Joint Utilities, for example, cite, as impediments to sale, the transaction costs of seeking lender and NRC approval; the difficulty of securing that NRC approval (including a need to show adequate long-term financial resources); the likelihood that bidders could be deterred by pervasive NRC regulation of day-to-day operations and the risks of nuclear operation in general or that those risks would enable bidders to strike hard bargains that failed to mitigate the stranded investment of the selling utilities; the need to ensure recovery by those utilities of their sunk costs and of the costs of decommissioning obligations they may retain; the relatively short remaining license periods for most nuclear units in the State; and the depressed value of generating capacity in New York, given the current over-supply.

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<sup>1</sup> Concerns about these impediments are raised by parties opposing the Staff proposal from diverse perspectives; they include Joint Utilities, Mr. Straka, the Utility Workers, LILCO, PULP, Con Edison, Central Hudson, WNY Environmentalists, Multiple Intervenors, and Oswego.

Other parties raise similar or related points. LILCO notes that three of the four non-NYPA nuclear units in the State have remaining license lives of 16 years or less, making them ill-suited for sale; the remaining plant, Nine Mile Point 2, represents only 5% of the State's generating capacity, and its sale, in itself, would have little effect on markets. Con Edison, stressing the length and complexity of the NRC's approval process and the attendant uncertainty, points as well to financial implications, discussed below, of having nuclear plants owned by entities other than utilities. PULP warns that a paucity of bidders and a directive to divest could depress bids by creating a "fire sale" atmosphere and that the resulting below-market-value sales prices would fail to mitigate stranded costs as Staff hopes. Central Hudson infers from Staff's offering of an administrative alternative that Staff itself doubts the practicability of an auction; it suggests, if the State favors auctions, that one of the NYPA plants be sold first, as a test case. Multiple Intervenors, similarly believing that NRC requirements (which may become still more rigorous than they already are) and financial demands on plant owners may preclude a market for nuclear assets, notes that New England Electric System has been unable to attract bidders for its share of five nuclear plants. The Utility Workers recognize that auctioning a plant may determine the level of stranded costs, but they deny that such a sale, at a price below book value, can do anything to mitigate stranded costs.

From a different perspective, WNY Environmentalists doubt that anyone except an unscrupulous operator would want to buy a nuclear plant, and Mr. Straka, warning of the consequences of selling to utility affiliates, similarly sees little likelihood of any sales to third parties.

Parties favoring Staff's proposal express confidence in the ability of the auction to go forward, to mitigate stranded costs more effectively than administrative valuation of nuclear plants, and to avoid cross-subsidies of nuclear generation by an affiliated T&D business. CPB, acknowledging that no nuclear

plant has yet been sold, points to evidence of movement in that direction, such as the formation of AmerGen, an entity formed by PECO Energy and British Energy "to acquire nuclear assets in the United States."<sup>1</sup> It suggests we clarify "that any purchase of a nuclear production facility is akin to purchasing a team, where the best performing teams with the best safety and cost performance records will attract the highest bids and where the value of those bids will surely be predicated on preserving the team that produced those results."<sup>2</sup> That perspective, it believes, would also preserve health and safety, protect deserving workers, and increase the likelihood of securing NRC approval for a transfer.

Pace, emphasizing the potential benefit of a successful auction's mitigation of stranded costs, suggests that utilities be encouraged to conduct auctions that produce the highest reasonable bids from the largest pool of buyers; these could include "financial incentives structured to increase with the size of the winning bid."<sup>3</sup> If an auction failed for want of bidders, however (suggesting thereby that the plant had no value), Pace would not necessarily allow stranded costs to be recovered from ratepayers. It adds that by announcing this potential exposure now (rather than reserving judgment pending review, as Staff suggests), we would provide a further incentive to designing effective auctions. NRDC similarly expresses confidence in the market, suggesting that the absence of bids in a well-run auction would be a signal that the market has determined that "the value of nuclear generation is too low and the risks too high,"<sup>4</sup> presumably warranting the closing of nuclear facilities. WEPCO asserts that "the market for electric generating facilities is already up and running, as evidenced by

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<sup>1</sup> CPB's comments, p. 9.

<sup>2</sup> Ibid., p. 8.

<sup>3</sup> Pace's comments, p. 3.

<sup>4</sup> NRDC's reply comments, p. 2.

the New England Electric System's recent highly successful auction."<sup>1</sup>

IPPNY, in its reply comments, specifically disputes PULP's view that Staff would require divestiture, even at "fire sale" prices; rather, it understands, Staff would encourage divestiture, perhaps strongly. IPPNY recognizes that any auction must be adequately competitive and sees a possible need to set a floor price by allowing the existing owner or its affiliate to submit a bid. It regards details such as these as among the matters to be considered in the further proceedings it advocates and asserts that "Joint Utilities at least agree that Staff's two principal recommendations (placing 'To Go' costs at risk, and nuclear plant auction) are conceptually feasible if certain, largely unspecified, conditions are met."<sup>2</sup>

2. Closure of Nuclear Plants  
as a Consequence of Their Sale

Joint Utilities, LILCO, and the Utility Workers assert that Staff's proposal would lead to the closure of nuclear power plants. Plants might be closed, they suggest, because of the impediments noted above to their successful operation in the market or because uncertainty regarding the outcome of the auction process could make it impractical to continue to operate them; in addition, the NRC might act to close them because of doubts about whether the new owners had the financial strength to ensure continued safe operation and ultimate decommissioning or whether a competitive market's revenue stream could, by itself, satisfy health and safety requirements. Such closures, these parties warn, could jeopardize the adequacy, diversity,

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<sup>1</sup> WEPCO's comments, p. 2. As already noted, NEES was unable to auction off its nuclear interests; WEPCO's reference to a successful auction may pertain to fossil-fueled facilities.

<sup>2</sup> IPPNY's reply comments, p. 6. In fairness, it should be noted that Joint Utilities, though regarding it as "conceivable" that nuclear plant sales might be feasible and appropriate, expresses doubt that the impediments to such sales can be resolved. (Joint Utilities' comments, pp. 11-12.)

reliability, and environmental compatibility of the State's power supply.<sup>1</sup>

With specific reference to environmental matters, Joint Utilities allege that "the Staff Report in this regard seems oddly inconsistent with State policy as reflected in the recent 'Power for Jobs Act,' retaining and more fully utilizing the FitzPatrick nuclear plant, in large part because of its environmental benefits."<sup>2</sup> They cite as well the 1994 State Energy Plan's estimate of the increased air pollutant emissions attendant on a shut-down of nuclear plants. (In their reply comments, Joint Utilities chide NRDC, Pace, and the Sierra Club for their asserted lack of interest in the clean air benefits of nuclear plants; NRDC, for its part, welcomes the utilities' concern for air quality but favors uniform internalization of all environmental costs and benefits of all generation sources, including renewables.<sup>3</sup> NYPIRG, meanwhile, takes a very different stance, worrying that Staff's proposal could artificially extend the lifetime for nuclear plants and therefore seeing the need for an EIS to assess the effects of that extension on the environment.) Con Edison acknowledges Staff's statement that future binding emission caps would have to be met regardless of fuel source, but sees that as affording little comfort if the retirement of nuclear generation had made low-emission generation unavailable in non-attainment areas. As for fuel diversity, Joint Utilities assert it rarely is valued until a crisis arises and will be of little if any concern to consumers

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<sup>1</sup> Utility Workers' Comments, pp. 3-4; Joint Utilities Comments, pp. 7-9. With regard to NRC concerns, the Joint Utilities cite a statement by the NRC that "increased competition could result in economic pressures that affect how licensees address maintenance and safety in nuclear power plant operations." (Discussion of proposed amendments to 10 C.F.R. Part 50, 62 Fed. Reg. 47590.)

<sup>2</sup> Joint Utilities' comments. p. 18.

<sup>3</sup> Joint Utilities' reply comments, p. 3; NRDC's reply comments, p. 1.

or entrepreneurs; they warn of the turmoil that would result if a crisis arose and nuclear generation were unavailable. Beyond that, LILCO adds, nuclear plant closings could raise the price of electricity to consumers, by removing relatively low-cost nuclear power from the market while leaving ratepayers responsible for both decommissioning costs and prudently incurred sunk costs not recovered through the auction price. (The latter concerns are discussed further below.)

Advocates of Staff's position, in contrast, suggest that a plant's closure would mean only that its operation had been found unwarranted by the market, to which all generation should be subjected. Citing Staff's principle that nuclear plants (like fossil and hydro) should operate only if their on-going costs can be recovered through the market, NRDC, for example, warns that "if power plants that cause serious environmental impact such as old dirty fossil plants and nuclear plants are given the equivalent of subsidies, restructuring will result in increasing air pollution and a growing nuclear waste disposal problem."<sup>1</sup> (NRDC would go further and bar efforts to shield nuclear plants from market forces by the use of long-term contracts for power.) WEPCO offers similar observations, adding that any diversity and clean air benefits provided by nuclear facilities will be reflected in the market price for their output. The AG likewise asserts that market pricing will enhance a nuclear plant's owner's ability to determine whether continuing the plant in operation makes economic sense. IPPNY warns that allowing owners of nuclear plants to recover costs from outside the market could perpetuate the existing excess of capacity and perhaps drive more efficient generators from the market. It asserts in its reply comments that, assuming prudent utility decisions, Staff's proposal would make plant closings no more likely than they would be under continued regulation.

### 3. Continued Operation Under New Ownership

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<sup>1</sup> NRDC's comments, p. 2.

The alleged safety risks associated with operation of nuclear plants in a competitive market have already been noted. To the extent it is alleged these concerns would be compounded by divestiture, IPPNY responds that other responsible entities can operate nuclear plants as safely as utilities, and that any financial pressures result from the very creation of a competitive market, not from Staff's proposal that utilities divest themselves of their nuclear plants.

As for the economics of continued operation, Joint Utilities and Multiple Intervenors warn that Staff's proposal would assign the benefits of nuclear plants' low energy costs to the entrepreneurs who purchase and operate them even though customers have borne (and will continue to bear, given what these parties expect to be the plants' low purchase prices and correspondingly high stranded costs) the associated costs (including decommissioning costs, discussed separately below). Multiple Intervenors urges us to ensure that customers not bear all uneconomic costs of nuclear plants and that they receive some of the economic benefit of the plants' low running costs; it suggests that nuclear plants may perform well on a going-forward cost basis.

Responding to this point, IPPNY asserts that the expected low energy costs that will be enjoyed by the buyer of the plant will increase the plant's value and be translated, given a proper auction, into a higher purchase price and consequently reduced stranded costs. "Customers may be exchanging a low energy cost 'benefit' for a lower stranded cost 'benefit,'" IPPNY says, "but it cannot be said that the benefit is being transferred to the new owner unless there is insufficient competition for the plant."<sup>1</sup> How to ensure that competition develops is among the details to be worked out, according to IPPNY.

Other parties express concern that purchasers of nuclear plants may gain excessive market power. Central Hudson

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<sup>1</sup> IPPNY's reply comments, p. 9.

sees this as a particular risk if utilities are barred from bidding, leaving the field to "multi-state mega-companies."<sup>1</sup> NRDC stresses that Staff's recommendation is that plants be sold to third parties, in the plural, and it warns that a single owner, be it public or private, could drive up prices, engage in predatory pricing, or skew the valuation of the plants being sold. PULP also warns of the potential market power of a single purchaser of all the sold plants, not precluded by Staff's recommendation, which could, among other things, close a nuclear plant in order to manipulate the market to the benefit of its other generation assets.

### Discussion

Staff's proposed auction makes sense in concept; if the plants could in fact be sold, and then closed or operated in a manner that obviated the various concerns raised by the parties, the auction would be an effective way to mitigate stranded costs, avoid subsidies to nuclear power, and generally ensure that nuclear power was a resource properly used or not used, as the case might be. But the parties' comments suggest, at a minimum, that no decision to mandate divestiture should be reached without further examination of its feasibility and likely consequences.

That the sale of a nuclear plant would be unprecedented does not, of course, argue against it; but the novelty does imply a need to proceed with considerable caution and to have better answers to a variety of questions before embarking on an uncharted course. To begin with the question of practicability, it is entirely possible that the difficulties and transaction costs of securing NRC and lender approval could make any sale so costly as not to be worthwhile. Those concerns are compounded by the relatively short remaining service lives of most nuclear plants in the State, and factors such as these could limit the number of bidders.

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<sup>1</sup> Central Hudson's comments, p. 5.

None of these concerns in itself precludes an auction, and some might lend themselves to mitigation. The effect of the short remaining service lives, for example, might be alleviated if several plants were sold to a single buyer as a group (though that, in turn, might lead to worry about the purchaser's market power). But all of these matters, problems and potential remedies alike, require further examination. Also worthy of further examination are questions related to the consequences of divestiture: might plants become more likely to be closed, because of NRC concerns about safety or because, as some comments suggest, closure might turn out to serve the short-term interest of the new owner; and how would any such closure, whatever its reason, affect prices, diversity, and the environment? Could the new owners, if they were few, gain harmful market power? Again, one need not assume the answers to these questions (and other pertinent ones) would warrant rejection of Staff's divestiture proposal; but the questions must be asked and answered before any decision is reached to pursue divestiture.<sup>1</sup>

#### DECOMMISSIONING ISSUES

##### Comments

In view of its concern over the safety of nuclear operations (and recognizing the NRC's interest in secure funding for decommissioning), Staff

recommend[ed] that prudently incurred decommissioning costs should continue to be paid by transmission and distribution customers after the transition. New York residents have a vested interest in a safe and environmentally benign retirement of nuclear facilities. In addition, the cost of decommissioning is not

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<sup>1</sup> It should be clear that we are not assigning to Staff's divestiture proposal the presumptive validity we have assigned to its market pricing proposal and that parties opposing it do not bear the correspondingly augmented burden of persuasion we referred to above. As we said in opening this discussion, divestiture makes sense in concept; but whether it is practicable remains an open issue.

affected significantly by additional operation of the facilities (i.e., the liability for clean-up does not increase with continued operation). Further, [ensuring] adequate decommissioning will enhance the value of the nuclear plants in the event they are sold to third parties.<sup>1</sup>

Several parties, including some that otherwise support Staff, express concern about various potential consequences and implications of leaving decommissioning responsibility with T&D companies and their customers, thereby separating it from ownership and operation of the plant. Con Edison, NRDC, PULP, and Pace fear that doing so would vitiate incentives to keep decommissioning costs, (which, they believe, can be affected by operating practices) to a minimum. PULP strongly disputes, as contrary to common sense, Staff's premise that operations will not affect decommissioning costs; it cites a contention by the Connecticut Department of Public Utility Control that one-half of the decommissioning costs of the Connecticut Yankee plant were due to utility mismanagement. Con Edison adds that the goal of maintaining low levels of radioactive contaminants would be frustrated by a transfer of the plant to a party interested only in maximizing electrical output. NRDC takes a more moderate view, agreeing in part with staff's premise but still expressing concern about removing an incentive to clean operation. Oswego regards the separating of ownership from decommissioning responsibility as inconsistent with the NRC's framework for protecting health and safety.

Other parties, agreeing with staff that the selling utility should remain responsible for the financing of decommissioning, consider the limits that should be imposed on the decommissioning costs it may recover from its T&D ratepayers. In its reply comments, IPPNY continues to urge that we endorse, as a policy matter, the premise that "prudently incurred decommissioning costs should continue to be paid by [T&D]

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<sup>1</sup> Staff Report, p. 5.

customers after the transition."<sup>1</sup> WEPCO urges the creation of incentive and penalty mechanisms rather than exclusive reliance on after-the-fact prudence reviews. Sierra Club, citing data said to show that decommissioning has been under-funded, would require shareholders to bear 50% of decommissioning cost over-runs. WNY Environmentalists, urging the immediate closure of all nuclear plants, would limit total cost recovery, including costs of decommissioning, to the wholesale price of electricity produced; they assert that "ratepayers did not create the mess made by nuclear plants. Ratepayers should not have to clean up after it."<sup>2</sup>

While the foregoing parties would protect T&D ratepayers by assigning a portion of decommissioning costs to T&D company shareholders, Pace would do so by assigning some decommissioning costs to plant operators (though it expresses concern that the sale of nuclear plants to companies lacking the "solid funding" of the T&D monopoly could result in inadequate decommissioning funds).<sup>3</sup> It reasons that the costs are uncertain, likely to grow, and subject at least in part to the control of the plant's owner/operator. It therefore urges us to consider an incentive mechanism, "in which the risks are shared between the Company and its customers."<sup>4</sup> It would do so, however, in the context of a generic inquiry into decommissioning, guided by three principles: adequate funding, equity between ratepayers and shareholders and across generations, and incentives to control costs and promote efficiency. In its reply comments, NRDC endorses this proposal.

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<sup>1</sup> IPPNY's reply comments, p. 16.

<sup>2</sup> WNY Environmentalists' comments, p. 3.

<sup>3</sup> Pace's comments, p. 4.

<sup>4</sup> Ibid., p. 5. Though the wording is ambiguous, context suggests that "Company" refers here to the plant purchaser, not the T&D utility.

Con Edison raises different financial matters, arguing, at some length, that the arrangements contemplated by Staff would substantially complicate and increase decommissioning funding requirements under existing and proposed NRC regulations, in effect requiring up-front financial assurances of a sort not required by an entity defined as an "electric utility" under NRC regulations. It maintains as well that the NRC's policies related to utility deregulation "appear to rule out decoupling of operational and decommissioning obligations," citing an NRC statement that "new owners and operators should assume the obligation to safely operate the facility and assure adequate funding for decommissioning, as they have the incentives to properly manage and operate the units."<sup>1</sup> Con Edison warns further that contributions to decommissioning trusts could lose their federal tax deductibility, which is available only when the contribution is made by a plant owner satisfying the NRC definition of an "electric utility."

Con Edison further maintains that the Staff proposal would change the established premise in New York that "required [decommissioning] funding will be tracked and collected ratably with appropriate adjustments made on an ongoing basis over the service life of the units."<sup>2</sup> Decommissioning timing would become less predictable and costs would increase, for the utility would lack information on post-divestiture changes in the facility and would be unable to conduct site-specific decommissioning planning. Meanwhile, the contemplated reversion of the plant to the utility for decommissioning would entail further costly NRC review and would be further complicated by the utility no longer having a nuclear staff (unless it had retained one on a standby basis). According to Con Edison, these and other financial and practical concerns require that sales of

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<sup>1</sup> Con Edison's comments, pp. 6-7, citing 62 Fed.Reg. 47594.

<sup>2</sup> Con Edison's comments, p. 7.

nuclear plants be linked with a transfer of decommissioning obligations and of funds accumulated in decommissioning trusts.

Joint Utilities see similar problems (and the additional one that a purchaser driven by economic concerns might shut a plant down early, thereby accelerating the need for fully funded decommissioning) but offer some possible, at least partial, solutions. Suggesting that the Staff Paper is ambiguous on the point, it requests clarification that while the selling utility would retain funding responsibility for decommissioning, the actual work would be the responsibility of the purchaser, as an incident of licensure, and that the purchaser would bear the risk of overruns in decommissioning costs.

CPB agrees with Staff that keeping financial responsibility for decommissioning with the selling utility will increase the value of the plant to a purchaser, thereby contributing to the mitigation of stranded costs. NYSEG, in contrast, though otherwise generally favoring staff's proposal, says we should "go further" and that the goal of the auctions should be not merely to sell the physical plants to third parties but also "to relieve the plants' present owners of all potential future liabilities, including the responsibility for decommissioning and spent fuel disposal," thereby "provid[ing] a finality that will benefit both the plants' owners and their ratepayers."<sup>1</sup> NYSEG is confident the NRC will permit plants to be sold only to entities financially capable of decommissioning them; and while it recognizes that including decommissioning in the sale will diminish the plant's purchase price and increase the stranded costs to be recovered from T&D ratepayers, it believes that adverse effect will be offset by the removal of the decommissioning charge from rates.

### Discussion

The comments have identified several matters related to decommissioning that warrant further attention. Perhaps most

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<sup>1</sup> NYSEG's comments, p. 2.

important, it appears unwise to relieve the plant's owner/operator of all responsibility for decommissioning costs by leaving them wholly with the surviving T&D company and its ratepayers. Staff's proposal recognized the public interest in ensuring adequate funding for decommissioning and site restoration as well as the prospect that making the new owners responsible for that funding could simply depress the plant's sale price by a corresponding amount; but placing total responsibility for decommissioning on the seller would remove any incentive for the purchaser to operate the plant in a manner that kept decommissioning costs as low as possible.

A further difficulty could arise if the surviving utility did not merely fund decommissioning but also had the plant actually revert to it for performance of the work, as the Staff report might be understood to permit. That might require, as Con Edison asserts, either the reassembly by the utility of a nuclear staff or its having maintained such a staff on a stand-by basis; either would be costly and cumbersome. On the other hand, having the purchaser do the work, funded by the selling utility, would compound the concern about vitiating incentives to keep decommissioning costs low. That, in turn, might warrant turning to Joint Utilities' suggestion, that the plant operator not only perform the work but also bear any cost overruns. That approach, under which the responsibility of the selling utility and its ratepayers would be limited to some reasonable pre-auction estimate of decommissioning costs, offers considerable promise, but how to carry it out--including the mechanism for making the pertinent estimate--would require further inquiry.

The financial, tax, and NRC issues that Con Edison raises with regard to decommissioning funding also warrant a closer look. It is not clear that Con Edison's warnings are well-founded; but neither can they be lightly dismissed, given the absence of any discussion of these matters suggesting a contrary conclusion and the magnitude of the potential financial exposure.

In sum, even if Staff's proposal were otherwise adopted, its treatment of decommissioning would require at least clarification and refinement and, perhaps, basic modification. These matters, too, can be addressed in the further inquiry we are undertaking.

#### TIMING

##### Comments

Several parties favoring staff's proposal urge that it be put into effect immediately, rather than after the transition period. The AG sees no reason why nuclear plants should not be subjected to the market during the transition period or why auctions should await its conclusion. WEPCO similarly asserts that if nuclear plants cannot be competitive, they should cease operations now. IPPNY and NRDC worry that waiting could allow uneconomic investments to be made during the transition period, ultimately increasing the stranded costs to be recovered. IPPNY suggests, in this regard, that some of the settlements governing the transition period permit ratepayer subsidies of uneconomic operations, to the detriment of competition, by permitting utilities to recover "going-forward" costs from outside the market through mechanisms such as Competitive Transition Charges (CTCs).<sup>1</sup> NRDC, doubting the effectiveness of price cap regulation as a bar to recovery of uneconomic costs during the transition, would have us declare, if divestiture did not begin immediately, that transition-period investments could be recovered by utilities only if they passed, in addition to the traditional prudence test, a strict market test analogous to that

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<sup>1</sup> IPPNY's comments, p. 2. IPPNY notes its intention to ask the FERC to reaffirm its position that a plant owner wishing to sell its output at market-based rates will not be allowed to use a CTC to collect going-forward costs. It adds, however, that it "continues to support the recovery of legitimate, verifiable and mitigated stranded costs, including stranded nuclear capital, decommissioning and spent fuel costs" and that it would regard a truly competitive auction as establishing a presumption that stranded costs had been mitigated.

offered by staff in its administrative alternative. Pace sees no need to delay the auctions and their attendant mitigation of stranded costs and elimination of anti-competitive subsidies. NYSEG would allow utilities to take advantage of favorable market conditions by giving them the flexibility to put their plants out for bid at any time during the transition period.

CPB does not call for immediate auctions, asserting that the transition period will allow time to prepare units for sale and design a fair auction process. Nevertheless, it recommends that sharing of stranded costs (via rate reductions) begin immediately rather than after the transition period. It argues that even the most efficient nuclear plants are less cost-effective than the alternatives and that there is no need to allow their utility owners full recovery of uneconomic costs. It offers an analysis of utility cash flows and investments that, in its view, warrants further rate reductions beginning in 1998; and it suggests they be accomplished by writing off some non-competitive production plant investment, imputing royalties from certain non-utility investment, or redeeming debt or equity securities.<sup>1</sup>

Joint Utilities respond, to CPB's and other sharing proposals, by objecting to the renewed consideration of what they see as confiscation of investor assets.<sup>2</sup> Con Edison objects to any suggestions for accelerated nuclear restructuring or stranded cost treatment that revisit the transition period arrangements specified in approved settlement agreements; it expresses surprise that some such proposals have been made by signatories to its settlement. Multiple Intervenors maintains that the parties calling for immediate auctions ignore not only the practical and regulatory difficulties associated with auctions

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<sup>1</sup> CPB's comments, p. 14. CPB says, however, that, contrary to its position in earlier competitive opportunities proceedings, it would not advocate common equity reacquisition that had the effect of reducing a company's equity ratio to below 40%.

<sup>2</sup> Joint Utilities' reply comments, p. 4.

but also the need for further study before it can be determined that an auction process is the best way to deal with nuclear investment.

Discussion

As Multiple Intervenors and various utilities argue, moving immediately to an auction would ignore the need for further study as well as undercut the settlement agreements that have been reached. Whether or not an auction is ultimately required, it should not be mandated before the end of the transition period.

NRDC, nevertheless, raises a legitimate concern about the possibility that stranded costs might be increased by uneconomic investment during a transition period. Its suggested announcement that recovery of transition period investments will be limited to those passing a market test deserves further study, including an examination of its underlying premise that a market test would differ from the traditional prudence test and an assessment of whether imposition of any such augmented test would be consistent with the approved settlements. These matters should be among the issues taken up earliest in the forthcoming inquiry.

PERMITTED PARTICIPANTS IN THE AUCTION

Staff's proposal disfavored, but did not bar, participation in an auction by a utility or its affiliate. It suggested such participation could pose a conflict of interest, in that "as a potential buyer of the generation, the utility, through its affiliate, seeks to minimize the price paid. The corporate interest, in this case, is not aligned with the interest of utility ratepayers."<sup>1</sup>

IPPNY would exclude utility affiliates from bidding, explaining that its earlier willingness, in the restructuring negotiations, to accept their participation was a pragmatic

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<sup>1</sup> Staff Report, p. 4.

compromise of the ideal. It expresses satisfaction at Staff's current endorsement of what it regards as a better position. Pace shares that view, endorsing Staff's judgment that complete divestiture of generation sources by T&D owners makes for a more efficient generation market.

Con Edison responds that excluding current licensees from the auction would unnecessarily shrink the pool of bidders and eliminate those best poised to obtain NRC approval. It suggests that any concerns about the market power that might be enjoyed by a generation company affiliated with a T&D company could be addressed by generally applicable anti-trust constraints. Central Hudson asserts that markets always seek to minimize the price paid for an asset but that the highest bidder will always win the auction -- a situation that will prevail whether or not utilities are permitted to participate. It adds that allowing utility participation will make it less likely that the market will be dominated by large, multi-state companies.

NYPIRG and the Sierra Club, meanwhile, would bar NYPA from participating in any auction. NYPIRG asserts that NYPA can use public funds to bail out a utility by buying a nuclear plant at an inflated price and then keep the plant operating while evading PSC regulation. The Sierra Club charges that NYPA is unaccountable.

The allegations regarding NYPA are unsupported; no reason has been shown to single it out for exclusion. The more general question, of whether and on what terms current owners of nuclear plants or their affiliates should be permitted to bid, is yet another issue that should be examined in the forthcoming inquiry.

#### ALTERNATIVES OR SUPPLEMENTS TO DIVESTITURE

As noted, the Staff Paper offered an "administrative alternative," to be applied with respect to nuclear plants for which no buyers came forward. In those situations, staff would limit recovery of "to go" nuclear costs (including prospective capital additions and property taxes) to the wholesale market

price of power. Staff reasoned that these arrangements would permit continued operation of nuclear plants that were efficient in comparison with other forms of generation, while causing other nuclear plants to be closed except where the owner was willing to incur short-term losses for the prospect of future gain. Recovery of sunk costs, including post-shut-down costs, would be subject to our review, in a process that considered the utility's efforts to mitigate those costs, including the steps it had taken to encourage competition.

Several parties regarded Staff's fall-back alternative as potentially superior to its primary proposal and certainly worthy of equal consideration. Others proposed modifications to the alternative or raised issues regarding the proper definition of "to go" costs, regardless of whether their recovery was to be seen as the primary or secondary method for dealing with nuclear power. In addition, NYPA and several utilities referred to their proposal for unified operation of their nuclear plants. All these matters are considered in this section.

### The Administrative Alternative

#### 1. Relative Merits of the Alternative

##### a. Comments

Multiple Intervenors objects to any presumption now that an administrative alternative would be a mere "second-best." Consistent with its overall agnosticism at this stage of the game, it urges further study not only of Staff's price-cap alternative (recognizing the importance of how "to go" costs are defined) but also of continued cost-based regulation (with enhanced incentives) and of a joint operation and maintenance agreement, another possibility discussed below.

PULP similarly disputes the premise that a market for nuclear assets is necessarily more effective than regulation in bringing about the efficiency gains and cost reductions that can flow from giving nuclear plant operators the proper price signals. It suggests those price signals emanate from the wholesale electricity market, and, once they do, the market-

clearing price can be used by regulators as well as by private plant owners in deciding when a nuclear plant should run. PULP goes on to urge further consideration of an administrative alternative under which all nuclear power is bid into the power exchange at running cost, the plant owner is paid the market-clearing price, and any difference is deferred for our later disposition in a manner that balances ratepayer and shareholder interests. Running costs that exceeded the market-clearing price would prompt our review of whether the plant should continue to be operated. Among the advantages of this alternative, in PULP's view, are its retention for ratepayers of the benefits of lower nuclear fuel costs and its preservation of our ability to ensure that fuel diversity and environmental concerns are considered in decommissioning decisions.

Con Edison, meanwhile, sees no need to pre-determine stranded nuclear costs, administratively or otherwise, and suggests the best way to protect customers against the inefficient operation of nuclear units is by conditioning cost recovery on prudent decisions based on properly determined "to go" costs. That, it says, together with "reasonably administered" fuel adjustment mechanisms and other performance incentive programs, "can essentially replicate market behavior and allocate financial risk appropriately."<sup>1</sup> Con Edison warns that divestiture could yield inadequate value for a plant if the purchaser underestimated the future market price of electricity and reduced its bid accordingly. It adds that the nuclear market share (comprising in toto about 14% of the State's generating capacity; only 9% of that capacity would be subject to divestiture pursuant to the Staff Report) is too small to cause market distortion or facilitate predatory pricing, and that the ISO would be able to diminish any advantage that a nuclear operator might otherwise enjoy by reason of affiliation with a T&D company, assuming proper calculation of "to go" costs.

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<sup>1</sup> Con Edison's comments, p. 13. See also Con Edison's reply comments, pp. 3-4.

Other parties asserting the benefits sought by Staff can better be achieved without divestiture include the Utility Workers and LILCO. WEPCO, in contrast, asserts that divestiture to unaffiliated entities will be the most effective way to mitigate stranded costs and that the values estimated through an administrative process would likely be understated. CPB similarly regards an auction as superior to administrative evaluation of a plant.

b. Discussion

The parties favoring the administrative alternative (or at least regarding it as not inferior to an auction), such as Multiple Intervenors and PULP, may be questioning the fundamental premise that regulation is at best a surrogate for the market and that a market-based regime should be introduced wherever practicalities or countervailing considerations do not preclude it. But, instead, they may be taking the less extreme position that the administrative alternative could be superior as a practical matter, given the many obstacles to successfully auctioning a nuclear power plant, and that a judgment cannot be made without further investigation of those obstacles. Staff's own view, which allows for the administrative alternative should the auction prove impracticable, may differ more in rhetoric than in substance; and, as already suggested, further examination is needed before a definitive practical answer can be given.

2. Costs to Be Subject to the Price Cap

a. Comments

Under Staff's administrative alternative, "recovery of 'to go' nuclear costs, including prospective capital additions and property taxes, [would] be limited to the wholesale market price of power."<sup>1</sup> Elsewhere in its report, in discussing its primary proposal, Staff states that a plant should be operated only if its running costs are no greater than the wholesale price

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<sup>1</sup> Staff Report, p. 8.

of electricity. Staff there defines "running costs" as "any costs [that] can be reduced or avoided if the plant is shut down permanently, e.g., fuel, labor and other operating costs, prospective capital additions, property taxes and insurance."<sup>1</sup> It is not clear whether "to go costs" and "running costs" are intended as synonyms; in any event, several parties have raised issues regarding the definition of "to go costs."

Con Edison, suggesting the convening of technical conferences to determine to go costs, regards the foregoing definition of running costs as a starting point, but only that; and it sees a need to exclude some of those costs from the price cap. It asserts that "considerable staffing, operating, insurance, and even capital costs" would not be avoided after a plant is shut down and therefore should be recoverable with sunk or decommissioning costs, and that costs associated with premature shutdown must be offset against avoided running costs.<sup>2</sup> It reasons that even if nuclear running costs exceeded the wholesale market price of electricity, it might be economic to continue operating the plant (allowing the utility to recover all prudently incurred running costs) as long as the excess of running costs over market price was less than the premature shutdown costs that were avoided by continued operation. Indeed, it warns, a plant purchaser indifferent to those premature shutdown costs (because they were to be borne by the utility and its customers) would be likely to close a plant prematurely, thereby accelerating decommissioning obligations.

Joint Utilities raise similar concerns, suggesting that Staff's definition of running costs overstates the incremental cost of continuing to operate a nuclear plant. They maintain that property taxes do not disappear if a plant is closed and that substantial operating costs endure as long as radioactive materials remain at the site. They add that the ceiling on

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<sup>1</sup> Ibid., p. 6.

<sup>2</sup> Con Edison's comments, p. 13.

recovery of to go costs should be the wholesale price of electricity plus shutdown costs. In reply, NRDC questions the utilities' new-found faith in cost-of-service regulation and asserts that the allowance of shutdown costs would depart from the market price standard and require us to engage in complex forecasting in order to duplicate determinations that the market makes best.

Oswego denies that property taxes will be avoided by a plant shut-down, maintaining they will be reduced only if the plant is decommissioned and removed from the site. (It adds, in a point discussed further below, that even if taxes could be reduced, that reduction (along with job losses) would have a devastating effect on the local community.)

IPPNY endorses staff's definition of to go costs as those that would be avoided by permanent shut-down, closure, and decommissioning; it says these would include, assuming removal of nuclear materials from the site, "essentially all fuel, capital additions, operating, payroll, and insurance expenses" but acknowledges that the extent of property tax reduction is an open question.<sup>1</sup>

CPB expresses concern about Staff's leaving recovery of sunk costs to our review. Reiterating its view that sharing of stranded costs should begin immediately, it recommends that "post-transition-period electricity supply prices be limited to market prices, indeed, even as it should be under regulation seeking to emulate the free-market."<sup>2</sup>

b. Discussion

The proper definition of "to go" costs, their relationship to running costs, and the degree, if any, to which costs might be allowed even if they exceed the wholesale price of electricity pose issues requiring further examination. As Con

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<sup>1</sup> IPPNY's reply comments, p. 13.

<sup>2</sup> CPB's comments, p. 14.

Edison suggests, they are best considered, at least in the first instance, in technical conferences.

NYNOC Proposal

1. Comments

In April 1997, the four entities operating nuclear power plants in New York State (NYPA, Con Edison, Niagara Mohawk, and RG&E) formed the New York Nuclear Operating Company (NYNOC). According to NYPA,

it is anticipated that NYNOC would operate and manage, but not own, the six nuclear electric generating facilities operating in New York State. It is expected that NYNOC will achieve operational excellence in all the [S]tate's nuclear power plants, resulting in the generation of electricity in a safe manner and at a competitive price. Cost reductions should be realized by NYNOC through consolidated management and operations and the uniform implementation of best industry work practices at the nuclear facilities. The plant owners would continue to market their plants' output and they would compete against each other and other electric generators in the market.<sup>1</sup>

Asserting that NYNOC (or some other similar arrangement) could quickly achieve results consistent with our policy of pursuing electric rate reductions, NYPA warns that the extended uncertainty associated with the Staff proposal, requiring numerous and complex steps including NRC review, would deter continued pursuit of NYNOC and have a chilling effect on the utilities' willingness to commit resources to it.

The NYNOC Utilities argue similarly, pointing to the prospect that NYNOC will provide ratepayers enhanced value for the State's nuclear assets, arguing that it would complement deregulation by enhancing the ability of the plants to deliver power in a cost-effective manner, and asserting that it would represent a significant step toward mitigation of stranded costs. But, they warn, the NYNOC effort presumes stable ownership of the

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<sup>1</sup> NYPA's comments, pp. 2-3.

plants and could be compromised by forced divestiture to unknown third parties that might have different views as to the plants' futures. Like NYPA, they also stress the deleterious effects on the NYNOC initiative of the extended period of uncertainty that would follow on adoption of the Staff proposal, particularly in view of the need for NRC approvals.

LILCO also favors an arrangement along the lines of NYNOC, under which nuclear plants would stay with their current owners but be "operated and managed by a dedicated professional organization of experienced nuclear operators" on the basis of "agreed generation schedules and agreed guidelines for plant shutdown or license extension."<sup>1</sup>

IPPNY, in contrast, characterizes NYNOC as "a good idea whose time is past."<sup>2</sup> Acknowledging that the proposal could produce efficiencies (though seeing a need for our oversight to ensure that the benefits of any such efficiencies flowed to ratepayers), it warns against the market power that could be exercised by NYNOC as a result of its controlling more than 25% of the State's generating capacity. It sees no merit in the concern that pursuit of Staff's proposal could frustrate NYNOC, asserting that if NYNOC is meritorious it should be pursued in any event (and utilities subjected to imprudence findings for failure to do so); that new owners of plants could participate in NYNOC if it were worthwhile; and that if NYNOC formation costs are expected to be significant and its benefits slow in arriving, utilities should consider whether the nuclear plants will remain open long enough to justify its pursuit.

NRDC asserts that if NYNOC will produce the promised benefits, it should be pursued regardless of who owns the plants; if, on the other hand, the seeming benefits are nothing more than subsidies (via tax-free NYPA debt or guaranteed long-term purchases by utilities), the initiative should be abandoned

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<sup>1</sup> LILCO's comments, p. 6.

<sup>2</sup> IPPNY's reply comments, p. 7.

regardless of what happens here. NRDC urges that NYNOC be evaluated separately from this proceeding, and it renews its call for utilities to be put on notice that they are at risk for above-market investments in nuclear facilities, including those needed to go forward with NYNOC.

## 2. Discussion

While it is true that a NYNOC-like arrangement might be instituted regardless of who owns the plants, it is the utilities (including NYPA) that have pursued it to this point and that are poised to carry it further if warranted. And while utility admonitions about the adverse effects of uncertainty should not deter us from pursuing divestiture if it seems clear that divestiture is the superior course of action, it is possible that the NYNOC proposal would allow the utilities to gain efficiencies that could work to the benefit of customers. Alternatively, NYNOC might be instituted for a transition period even if divestiture ensued.

The comments in this case, of course, fall far short of containing all the information needed to evaluate NYNOC. The matter should be pursued further (within the inquiry here established or separately, whichever seems more efficient at the time) following submission by the NYNOC participants of a formal proposal.

### EFFECT ON MUNICIPALITIES

Contending that we must consider the effects of Staff's proposal on municipalities, Oswego, which is home to much generating plant, asserts that Staff has failed to consider the property tax implications of an auction. Oswego foresees a significant loss of property tax revenues from the plants at issue, accompanied by a corresponding increase in the property taxes of other entities, and it warns that "the certainty of significant tax increases will nullify any benefit to the New York State economy being pursued under the misguided rouse [sic]

that competition is New York's patent cure-all remedy."<sup>1</sup> It calls into question what it takes to be Staff's implications with regard to the tax consequences of its plan, and it asks that Staff be required to present a detailed report on these matters, particularly with regard to assessment practices.

In response, IPPNY, though recognizing the reality of Oswego's concerns, says they are matters to be addressed by the Legislature, not by us. But it objects to any proposal to subsidize Oswego (or other similarly situated municipalities) with funds recovered from other electricity customers through wires charges, and it contends that municipalities will have to tax producers of electricity in the same way they tax producers of other products, i.e., competitively. Multiple Intervenors also sees Oswego's concerns as more properly directed to the Legislature. Though it sees a general need for further study before proceeding, it does not regard tax considerations as a reason to retain the status quo.

While the needs of the municipalities that are home to nuclear generating plants should not be allowed to determine how those plants are treated, reasonable arrangements should be considered to help those municipalities weather transitions in property tax assessments. And while resolution of these issues may require action by the Legislature, interested municipalities will be permitted to present their concerns to us in the inquiry we are instituting.

#### CONCLUSION

For all the reasons previously discussed, the proposals in the Staff Report, though by and large consistent in concept with our goal of a competitive, market-based electricity industry, require more extensive examination. That examination should begin with a collaborative process and move to litigation on particular issues if necessary. The precise structure, procedures, and timetable for the examination should be

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<sup>1</sup> Oswego's comments, p. 8.

determined by Staff and the Administrative Law Judge, but they should aim to bring the case to us for final decision within six to nine months after the ISO is started and in no event later than the second quarter of 1999.<sup>1</sup> The issues described in this opinion should be seen as a basic agenda for the inquiry, but other pertinent matters may be raised as well. Finally, as explained above, we adopt as a rebuttable presumption the premise that nuclear power should be priced on a market basis to the same degree as power from other sources, and parties challenging that premise bear a substantial burden of persuasion.

The Commission orders:

1. An inquiry shall be conducted into the matters described in the foregoing opinion.
2. These proceedings are continued.

By the Commission,

(SIGNED)

JOHN C. CRARY  
Secretary

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<sup>1</sup> If it appears that a speedier decision is needed with regard to particular items, such as the NYNOC proposal, the schedule for such items should, of course, be accelerated to the extent possible.

PARTIES SUBMITTING COMMENTS<sup>1</sup>Comments

(AG) Dennis C. Vacco, New York State Attorney General

(Central Hudson) Central Hudson Gas & Electric Corporation

(Con Edison) Consolidated Edison Company of New York, Inc.

(CPB) New York State Consumer Protection Board

(IPPNY) Independent Power Producers of New York, Inc.

(Joint Utilities) Central Hudson Gas & Electric Corporation, Long Island Lighting Company, Niagara Mohawk Power Corporation, and Rochester Gas and Electric Corporation

(LILCO) Long Island Lighting Company

## Multiple Intervenors

(NRDC) Natural Resources Defense Council

(NYNOC Utilities) Consolidated Edison Company of New York, Inc., Niagara Mohawk Power Corporation, and Rochester Gas and Electric Corporation

(NYPA) New York Power Authority

(NYPIRG) New York Public Interest Research Group, Inc.

(NYSEG) New York State Electric & Gas Corporation (NYSEG)

(Pace) Pace Energy Project

(Oswego) City of Oswego

(PULP) Public Utility Law Project of New York, Inc.

(RG&E) Rochester Gas and Electric Corporation

(Sierra Club) Sierra Club - Atlantic Chapter

(Mr. Straka) Mr. Charles A. Straka, pro se

[continued]

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<sup>1</sup> This list includes as well the short designations used to identify parties in the text of the analysis. To better guide the reader, the short designation appears first and the list has been alphabetized by short designation.

(Utility Workers) Local 1-2, Utility Workers of America, AFL-CIO

(WEPCO) Wheeled Electric Power Company

(WNY Environmentalists) Western New York Environmentalists

Reply Comments

Con Edison

CPB

IPPNY

Joint Utilities

Multiple Intervenors

NRDC

Utility Workers