

UNITED STATES OF AMERICA
NUCLEAR REGULATORY COMMISSION

**Title: BRIEFING ON ELECTRIC UTILITY INDUSTRY
 RESTRUCTURING AND DEREGULATION -
 PUBLIC MEETING**

Location: Rockville, Maryland

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2 NUCLEAR REGULATORY COMMISSION

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4 BRIEFING ON ELECTRIC UTILITY INDUSTRY
5 RESTRUCTURING AND DEREGULATION

6 *****

7 PUBLIC MEETING

8
9 Nuclear Regulatory Commission
10 One White Flint Plaza
11 11555 Rockville Pike
12 Rockville, Maryland

13
14 Thursday, December 14, 1995
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16 The Commission met in open session, pursuant to
17 notice, at 10:00 a.m., the Honorable SHIRLEY A. JACKSON,
18 Chairman of the Commission, presiding.
19

20 COMMISSIONERS PRESENT:

21 SHIRLEY A. JACKSON, Chairman of the Commission
22 KENNETH C. ROGERS, Member of the Commission
23
24
25

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1 STAFF AND PRESENTERS SEATED AT THE COMMISSION TABLE:

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JOHN C. HOYLE, SECRETARY

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KAREN D. CYR, GENERAL COUNSEL

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ELIZABETH ANNE MOLER, CHAIR, FEDERL ENERGY

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REGULATORY COMMISSION

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ROBERT W. GEE, COMMISSIONER, PUBLIC UTILITY

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COMMISSION OF TEXAS

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E. LINN DRAPER, JR., CHAIRMAN, PRESIDENT & CEO,

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AMERICAN ELECTRIC POWER SERVICE CORPORATION

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CAREN BYRD, PRINCIPAL, MORGAN STANLEY & COMPANY

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P R O C E E D I N G S

[10:00 a.m.]

CHAIRMAN JACKSON: Good morning. I would like to welcome everyone to today's briefing on Electric Utility Restructuring and Deregulation.

I would like to acknowledge and welcome the individuals who have agreed to come today to meet with the Commission to discuss this very important topic. I would like to introduce the Honorable Elizabeth Moler, Chair of the Federal Energy Regulatory Commission; the Honorable Robert Gee, Commissioner of the Public Utility Commission of Texas; Dr. Linn Draper, Chairman, President, and CEO of AEP Service Corp; and Ms. Caren Byrd, Principal from Morgan Stanley & Company.

As you know, the electric utility industry is facing substantial challenges and changes that is, in fact, changing business practices. At the present time, the industry is restructuring in an effort to stay competitive, to lower electric rates to consumers, and to respond to Federal and State regulatory initiatives.

Policy decisions of the State public utility commissions, as well as the Federal Energy Regulatory Commission, are the source of much of this activity, following on particularly the heels of the Energy Policy Act of 1992.

1 Different States are approaching the new
2 possibilities in quite different ways. Rate deregulation,
3 restructuring, and competition are posing unique challenges
4 to utilities and to the NRC that, as of today, are not
5 completely defined.

6 The NRC must keep abreast of how these changes and
7 economic constraints affect reactor licensees, as that is
8 our focus.

9 In a competitive market, the Commission as the
10 nuclear utility regulator must ensure that the nuclear
11 electric generators continue to maintain high safety
12 standards, with sufficient resources devoted to nuclear
13 operations, and the decommissioning funding assurance be
14 maintained.

15 These are issues that the NRC cannot shy away
16 from. The NRC must determine whether our current regulatory
17 requirements are fully adequate or whether additional
18 rulemaking is necessary as a result of this changing
19 business environment.

20 The Commission would like to discuss these issues
21 today, as they relate to economic competition and
22 restructuring in the electric utility industry, and we had
23 sent you some questions, I know, beforehand that we are
24 looking forward to hearing your views on, and others.

25 I would also like to say that I think the way we

1 will restructure this is to have each of you, beginning with
2 the Honorable Moler, then Mr. Gee, Dr. Draper, and Ms. Byrd,
3 and for each of you to give your statements, and then we
4 will have questions directed to you.

5 If any questions are directed to one, but any
6 others have comments, we would appreciate hearing them.

7 Commissioner Rogers, do you have any opening
8 comments?

9 COMMISSIONER ROGERS: Nothing in addition. Thank
10 you.

11 CHAIRMAN JACKSON: If not, we will be happy to
12 hear from you.

13 MS. MOLER: Chairman Jackson, Commissioner Rogers,
14 and colleagues, thank you for the opportunity to be here
15 this morning.

16 Today, I am pleased to be able to discuss with you
17 the significant changes that are taking place in electric
18 industry since the Energy Policy Act passed in 1992 and the
19 regulatory initiatives we at the Federal Energy Regulatory
20 Commission have underway to ensure a smooth transition to
21 competition.

22 Our goal is simple. We want to guarantee all
23 power generators nondiscriminatory access to transmission
24 lines, so the buyers and sellers can get together and
25 competitive wholesale markets can flourish. These markets

1 ultimately will bring lower electricity rates to the
2 Nation's consumers.

3 There are three major points I wish to emphasize
4 with you today. First, all consumers should be able to reap
5 the benefits of competitively priced generation. Those who
6 control the Nation's transmission grid must be required to
7 provide nondiscriminatory open access to all wholesale
8 sellers and buyers of electric energy. We are in the midst
9 of a major rulemaking initiative that will make wholesale
10 open access a reality.

11 Second, we at the FERC must ensure a fair and
12 orderly transition from regulation to competition.
13 Wholesale stranded cost recovery is inextricably linked to
14 the Commission's open access initiative. Open access will
15 not succeed without a fair transition cost mechanism.

16 Third, in addressing open access and stranded
17 cost, the Commission has proposed and will take no action
18 inimical to the safety or reliability of the Nation's
19 nuclear powerplants.

20 As you have noted, Chairman Jackson, the electric
21 industry is today an industry in transition. In response to
22 changes in the law, technology, and markets, competitive
23 pressures are steadily building. Today, new generation
24 facilities can produce power at a cost of about 3 to 5 cents
25 per kilowatt. Yet, consumers in some regions of the country

1 are paying 9 to 11 cents per kilowatt. Not surprisingly,
2 those consumers want access to the cheaper sources of power,
3 and those sources want access to the market.

4 In the Energy Policy Act of 1992, Congress gave us
5 new authority to order wholesale transmission services on a
6 case-by-case basis. It also gave a green light for new
7 entrance in the generation sector of the electric power
8 business, known as exempt wholesale generators, or EWGs.
9 The impact of these changes has already been enormous.

10 As the Commission began implementing the new
11 electric provisions, however, it soon became clear that we
12 need to use our other regulatory tools under the Federal
13 Power Act to make wholesale competition work better.

14 Competitive pressures have grown faster than any
15 of us could have possibly anticipated. Wholesale buyers
16 want access to cheaper power. Wholesale sellers want the
17 ability to compete on a fair basis. Buyers and sellers
18 complain that transmission-owning utilities were treating
19 themselves better than their customers.

20 Last year in a case involving the AEP companies,
21 the Commission ruled the public utilities may not give
22 themselves a preference over third parties wishing to use
23 their transmission wires. The golden rule of comparability
24 was born.

25 Since then, we have applied the comparability rule

1 to a broad array of cases, including mergers and requests
2 for market-based generation rates, as well as open access
3 transmission filings.

4 As we progressed, however, utilities began asking
5 the Commission to define the comparability principle in
6 greater detail. Many, such as Mr. Draper's company, were
7 willing to comply, but they needed better guidance from the
8 Commission about what type of transmission tariffs would be
9 acceptable to us. It became apparent that the only way to
10 remedy existing undue discrimination is to act generically.

11 In addition, we became concerned about the need to
12 provide a smooth transition through these competitive
13 changes. As a result on March 29th of this year, we issued
14 as Notice of Proposed Rulemaking that would require
15 utilities, subject to our jurisdiction, to provide open
16 access transmission services, and also would deal with the
17 issue of stranded costs.

18 I will not go into great detail about the proposed
19 rulemaking. In essence, it requires all utilities to
20 provide open access at nondiscriminatory and comparable
21 rates, terms, and conditions.

22 We suggested pro forma tariffs that the utilities
23 would be required to adopt. We are also proposing a
24 reciprocity requirement for utilities that are not subject
25 to our jurisdiction. If the nonjurisdictional utilities

1 want to use the jurisdictional utilities open access, they
2 must offer open access in exchange.

3 The rulemaking also proposes to allow electric
4 utilities to seek recovery of stranded costs. These costs
5 are the sunk investments such as nuclear investments, and
6 other costs that a utility prudently incurred to serve its
7 existing customers.

8 As we stated in our stranded cost proposal, the
9 electric utility industry has billions of dollars invested
10 in utility assets and contracts that, in today's markets,
11 may prove to be uneconomic.

12 If wholesale or retail customers leave their
13 utility systems without paying a share of these costs, the
14 costs will become stranded, unless they can be recovered
15 either from the departing customers or other customers.
16 These costs were incurred under a regulatory system that
17 imposed upon utilities an obligation to serve, an explicit
18 obligation at retail, and the expectation of a requirement
19 to serve in wholesale transactions based on the history of
20 supplier-buyer relationships.

21 In our proposed rulemaking, we stated our belief
22 that utilities that made large capital expenditures or
23 long-term contractual commitments to buy power, many years
24 ago, should not now be held responsible for failing to
25 foresee such fundamental changes in this industry.

1 We stated that we will not ignore the effects of
2 regulatory and statutory changes on the past investment
3 decisions of utilities. We believe that equity requires
4 that utilities have an opportunity to recover legitimate and
5 verifiable stranded costs associated with the development of
6 wholesale competitive power markets.

7 I want to make clear that this opportunity extends
8 to any nuclear power generation assets that may be stranded
9 in the competitive marketplace. Our proposal is
10 fuel-neutral. We make no distinction as to the type of
11 generation for which stranded cost recovery may apply.
12 Thus, investments in nuclear powerplants, as well as
13 decommissioning costs associated with those investments,
14 could be recovered.

15 I also want to point out, and Commissioner Gee
16 will go into this in considerably greater detail, that the
17 majority of any stranded costs would not be the result of
18 any FERC-required wholesale open access. That is because
19 most utility costs, over 80 percent, are incurred serving
20 retail rather than wholesale customers. Therefore, most
21 stranded costs will be the result of a State regulatory
22 commission's requirements that a utility provide direct
23 access or retail wheeling, which would permit its retail
24 customers an opportunity to reach other power suppliers.

25 Retail wheeling is specifically in the hands of

1 the States because the Energy Policy Act forbids FERC from
2 ordering retail wheeling. If utilities are to recover costs
3 stranded by retail wheeling, such recovery must be through
4 jurisdictional mechanisms available to the State.

5 Importantly, I believe that our decision to deal
6 immediately and comprehensively with stranded costs as an
7 essential element of our open access initiative will serve
8 -- I hope, I should say, that it will serve as a model for
9 the States.

10 Our informal discussions with State regulators who
11 are pursuing retail wheeling initiatives have been somewhat
12 reassuring in this regard.

13 Since we issued our proposed rule, there have been
14 other developments in the competitive world. The California
15 Public Utilities Commission has issued a proposal for retail
16 competition. Twenty-nine other States are now exploring
17 options for addressing electric restructuring issues.
18 However, it is still too early to tell where these
19 experiments and investigations will lead.

20 We are not proposing to restructure the electric
21 industry. We do not propose to aggregate existing contracts
22 or to require the divestiture of significant assets. We do
23 not propose to require corporate reorganization along
24 functional lines of generation transmission and
25 distribution, though I will tell you that many of the

1 commenters have suggested that we pursue this.

2 At this juncture, let me state plainly and
3 unequivocally that nothing we propose affects the safety or
4 reliability of the transmission or generation of the
5 Nation's electric power. We at the FERC take seriously our
6 obligation to act in the public interest.

7 We have had a phenomenal response to the Notice of
8 Proposed Rulemaking. We received over 20,000 pages of
9 comments from over 400 commenters. We have begun the task
10 of analyzing those comments. We have had several technical
11 conferences on the issue, and we have had an on-the-record
12 dialogue with our colleagues, the State regulatory
13 commissioners at the National Association of Regulatory
14 Utility Commissioners meeting in New Orleans, and we are
15 developing an environmental impact statement for the
16 proposed rule.

17 We are working hard to encourage utilities to file
18 open access tariffs before we put the generic rules in
19 place. Many utilities have already responded positively to
20 our efforts. When we issued the NOPR in March, 21 electric
21 systems had filed some sort of open access tariff with us,
22 including AEP. We now have more than doubled that number,
23 with a total of 48 electric systems that have filed some
24 sort of open access tariff. That includes several of the 21
25 who have upgraded their open access tariff that was on file

1 at the time.

2 To date, we have accepted 39 of these tariffs. A
3 large number of these tariffs offered a high-quality
4 transmission service that would be required under the
5 proposed pro forma tariffs, and though we have had
6 considerable success, we have a long way to go.

7 When we issued the NOPR, we thought that about 137
8 of the Nation's utilities would be required to have some
9 sort of open access subject to our jurisdiction because of
10 their ownership of transmission lines that are subject to
11 our jurisdiction.

12 We consider our initiative to be a success story
13 in the making. Many progressive utilities are beginning to
14 see the advantages of open access to the benefit of
15 consumers.

16 To date, we have not received any indication from
17 the many participants, including State regulators, that the
18 proposed rules, if implemented, would threaten the safety or
19 reliability of nuclear powerplants, nor would I expect any.

20 We establish rates and we order transmission
21 access. Our proposal does not touch in any way, shape, or
22 form existing State or Federal laws or your regulations
23 involving safety or licensing matters.

24 To be sure, there is the claim advanced by some in
25 our proceedings that competition in driving managers to cut

1 costs will drive management to cut corners. We will, of
2 course, respond to these comments in the course of our
3 proceeding, but let me give you my personal observation on
4 this issue.

5 We do assume that competitive pressures will
6 improve efficiencies. Indeed, competition is here now, and
7 we have seen this happen. However, to assume that safety or
8 reliability will be compromised as a result is to assume
9 utility executives will break the law, and State and Federal
10 regulators will relax enforcement.

11 I believe this is a wholly untenable assumption.
12 To the extent that wholesale competition affects the
13 marketability of power from nuclear powerplants, I am
14 confident that our 100-percent recovery of stranded costs
15 will provide the utilities with the means to provide
16 responsibility for reliability and safety concerns.

17 In summery, the electric utility industry is well
18 on the road to development of more competitive bulk power
19 markets that will more efficiently and effectively serve the
20 needs of the Nation's electric consumers.

21 The key components of achieving competition are
22 open access transmission, services for all wholesale buyers
23 and sellers of electricity, and the fair allocation of the
24 stranded costs that result from transition to competition.
25 We are using the tools that Congress gave us to effectively

1 address these issues in a manner that does not compromise
2 safety or reliability.

3 I appreciate your interests in our efforts, and it
4 is a pleasure to come to the Nuclear Regulatory Commission
5 and have a dialogue on these issues.

6 Thank you.

7 CHAIRMAN JACKSON: Thank you.

8 Mr. Gee?

9 MR. GEE: Chairman Jackson and Commissioner
10 Rogers, I greatly appreciate the NRC's invitation to be here
11 today at today's briefing on electric utility industry
12 restructuring and deregulation.

13 While I am Chair of the Committee on Electricity
14 of the National Association of Regulatory Utility
15 Commissioners, unless specifically noted, I do not appear
16 today as spokesperson for the NARUC.

17 I strongly commend the Commission for undertaking
18 today's conference. During this period of fundamental
19 change in the structure and operation of utility systems, it
20 is critical that the industry's economic regulators, State
21 commissioners and the FERC, and nuclear safety regulators at
22 the NRC maintain a continuing dialogue to ensure that the
23 transition to greater competition does not compromise safety
24 or reliability.

25 My NARUC colleagues and I look forward to an

1 effective working relationship with both the FERC and the
2 NRC as the restructuring debate continues.

3 Questions concerning the restructuring and
4 deregulation of electric utility industry are being debated
5 today in Washington and in State capitals, prompted
6 primarily by three factors:

7 First, the 1992 enactment of the Energy Policy
8 Act, which promoted the development of independent wholesale
9 power producers through exemption from the Public Utility
10 Holding Company Act and the opportunity to access new bulk
11 power markets through transmission access orders issues by
12 the FERC under a revised Section 211 of the Federal Power
13 Act;

14 Second, the FERC's subsequent proposal to issue
15 generic rules that require utilities to provide unbundled
16 transmission services under a tariff on a system-wide basis;

17 And third, proposals and final decisions in State
18 commissions and legislatures to permit retail customers to
19 choose alternate sources of power generation to be delivered
20 to them via retail wheeling.

21 Because the great majority of electric services,
22 over 80 percent, are provided at retail subject to State
23 regulation, as Chair Moler pointed out, industry
24 restructuring will evolve on a State-by-State basis, unless
25 Congress enacts legislation adopting a national model.

1 As a result, States are taking a variety of
2 approaches to restructuring deregulation issues. The recent
3 report found that more than half of the States have started
4 serious investigations of restructuring issues. This report
5 noted that 12 States have issued or are about to issue
6 reports on their findings.

7 In addition to Commission investigations, State
8 legislatures have also become involved in enacting
9 legislation to facilitate restructuring. The kinds of
10 initiatives the States are considering include customer
11 choice through retail wheeling, rate reform through the
12 adoption of performance-based rate-making structures and
13 electric development rates, and elimination of exclusive
14 retain service territories.

15 However, I would anticipate that States would
16 proceed cautiously in each of these areas, using small-scale
17 experiments in customer choice, such as in Michigan, are
18 phasing in retail wheeling through pilot programs, such as
19 New Hampshire.

20 While it is very early in this process of change,
21 there are discernible trends at work, at least at the
22 general level. First, I would expect that utilities would
23 be required to offer services competitively at both
24 wholesale and, in some States, retail on an unbundled basis.
25 This will require changes to the integrated structure of the

1 electric utilities in which generation, transmission, and
2 distribution services are provided as a package.

3 The form this could take ranges from functional
4 unbundling, wherein a utility offers services priced and
5 provided separately -- in fact, this is the option proposed
6 by the FERC for wholesale services in their proposed rule --
7 to corporate restructuring, wherein utility establishes
8 separate corporate subsidiaries to provide generation
9 transmission and/or distribution services to more
10 comprehensive structural reform involving spinoffs of
11 ownership of generation, transmission, and/or distribution
12 facilities.

13 The second general area of change involves the
14 implementation of market-based pricing policies. For its
15 part, the FERC has declared that newly acquired wholesale
16 generation is now competitive and, accordingly, need no
17 longer be regulated on a cost-of-service basis under the
18 Federal Power Act.

19 While few, if any, States have authorized
20 market-based pricing for retail services at this time,
21 implementation of retail customer choice could result in
22 movement from a tariff-based system to a system based on
23 contracts between power suppliers and customers, presumably
24 at market.

25 In addition, as I mentioned, States are now

1 experimenting with alternative rate-making approaches for
2 retail utility sales that depart from traditional
3 cost-of-service methodologies.

4 The purpose of these reforms is to create
5 ratemaking incentives for a utility to improve the
6 efficiency of its operations. For example, PBR proposals
7 permit utilities to retain some of the benefits of their
8 efforts to reduce cost.

9 One possible outcome is that current rate
10 disparities between utilities would be reduced as rates
11 converged toward a market-determined regional average.

12 The third trend we observe is that open access
13 wholesale transmission will accelerate the growing trend
14 toward regionalism. Transmission planning will be conducted
15 on a regional basis; in some cases, through what are known
16 as regional transmission groups. Power pools may be
17 operated by independent system operators on a region-wide
18 basis, and bulk power wholesale markets will be priced
19 regionally. It will test the creativity of both Federal and
20 State regulators to invent a workable institutional
21 framework to match this important market development.

22 I know that the Commission is keenly interested in
23 the pace at which these changes take place. If
24 restructuring proceeds on a State-by-State evolutionary
25 track, which in my view is the prudent way we should

1 proceed, it could take at least 10 years before a majority
2 of U.S. retail consumers are served by restructured electric
3 service companies.

4 Some States may reject restructuring entirely,
5 favoring continuance of the vertically integrated
6 cost-of-service, exclusive service territory model.
7 However, enactment of congressional legislation which takes
8 decision-making out of State hands, could accelerate and
9 broaden retail restructuring.

10 While restructuring activities have moved quickly
11 in wholesale markets regulated by the FERC, it is clear that
12 we are still in the trial-and-error stage at the retail
13 level.

14 I firmly believe diversity of State
15 decision-making will be beneficial to the development and
16 implementation of practicable policies. It is particularly
17 important, in our view, that State commissions and
18 legislatures be afforded substantial flexibility to
19 experiment with alternative legislative and regulatory
20 approaches to these critical issues.

21 Of course, one of the key considerations that
22 State decision-makers will be called upon to address with
23 flexibility and creativity is the effect that industry
24 restructuring initiatives might have on utilities operating
25 nuclear powerplants.

1 First, let me state unequivocally that each State
2 regulatory grappling with the changing utility industry
3 fully understands the need to ensure the safety and
4 reliability of nuclear plant operations not be compromised
5 in any way. We fully support the NRC's efforts to ensure
6 that a utility industry made more efficient through the
7 forces of competition remains a safe and reliable industry.
8 In my view, the goals of improved efficiency through
9 restructuring and continued safety are not incompatible.

10 In the remainder of my remarks, I would like to
11 address two areas which I understand are of particular
12 concern to the Commission, the effect of the stranded cost
13 issue on utility operations including the likelihood of
14 early plant shutdown and decommissioning.

15 First, as to stranded cost recovery, some
16 utilities currently own nuclear plants, as well as
17 non-nuclear assets whose unrecovered value in utility rate
18 base exceeds their value in the market at current prices.
19 It is argued that greater competition from less expensive
20 generation sources will expose these plants as uneconomic,
21 forcing their owners to shut down operations.

22 However, it is not necessarily the case that an
23 action by a utility to write down the rate-based value to
24 the market value and adjust prices accordingly means that
25 the plant will be shuttered. Once written down, such plants

1 may be highly competitive due to their relatively low
2 variable costs.

3 Plants may be shut down earlier than expected, but
4 for reasons other than uncompetitiveness, such as cost of
5 repairs and retrofits, as in cases of Trojan and Yankee Rowe
6 plants.

7 As commonly understood, the stranded costs of
8 nuclear plants are sunk costs already expended. Shutdown
9 will yield no savings to the utility for such costs.

10 Moreover, to address the question of who pays for
11 the write-downs, State commissions are now in the process of
12 developing cost recovery mechanisms, such as non-bypassable,
13 competitively neutral wires, charges, and exit fees that
14 fairly and effectively allocate stranded costs. Here again,
15 we see no need for a one-size-fits-all approach to what is a
16 very traditional regulatory question involving cost
17 identification, allocation, and rate design.

18 Turning to the second area of concern,
19 decommissioning, I would not expect that the adoption of
20 diverse regulatory policies by the State commissions and
21 legislatures will necessarily make it more difficult for the
22 NRC to continue to use generic decommissioning requirements.

23

24 The fact that some States may authorize or require
25 that utilities depart from cost-based ratemaking

1 methodologies, while others adhere to traditional policies,
2 does not mean that the NRC cannot issue regulations imposing
3 an obligation on the nuclear utilities to adequately fund
4 decommissioning and factor that expense into their revenue
5 structures.

6 The States and FERC will then bear the
7 responsibility of seeing that legitimate costs of service
8 are recoverable. If necessary, the NRC may wish to consider
9 regulatory approach that establishes options for compliance,
10 rather than a single set of requirements.

11 However, in any reconsideration of its
12 decommissioning policies, the Commission should be mindful
13 of their competitive impact on the companies.

14 For example, by raising costs, increases in
15 decommissioning trust funding could make a utility less
16 competitive, all things being equal. Accordingly, to the
17 extent that an increase in decommissioning funding raises
18 the utility's variable cost to the point that the plant in
19 question becomes uncompetitive, separate and apart from sunk
20 recovery costs, sunk recovery issues, it could be
21 counter-productive for the NRC to increase this expense too
22 far too fast.

23 Similarly, there may be some benefit to an NRC
24 policy that requires its licensees to recovery their full
25 decommissioning funding over the next 10 years on the

1 assumption that retail markets will not be fully competitive
2 until then. Such a policy would be similar to the plans of
3 some States, for example, California, that are considering
4 accelerating plant depreciation schedules to work off
5 potentially strandable costs prior to full competition.

6 As noted, the effect of accelerating the
7 collection of decommissioning or plant costs is to increase
8 the utility's costs, which may worsen its ability to
9 compete.

10 The insurance alternative discussed in the
11 Commission's letter of invitation to today's conference may
12 make more sense than accelerated decommission cost
13 collection provided in a structure to spread the risk of
14 unfunded decommissioning expenses more broadly and, thereby,
15 reduce the competitive harm that increases costs would have
16 on an individual firm. I would suggest that this option be
17 studied by the Commission in consultation with the
18 industry's existing insurance programs.

19 In its list of questions, the Commission has also
20 raised the matter of industry reorganization to mergers or
21 asset transfers. To the extent that nuclear assets are now
22 subject to State and Federal regulatory jurisdiction, their
23 ownership cannot be transferred without the authorization of
24 each affected State commission and the FERC.

25 Provided that the entity to which a nuclear plant

1 is transferred is or would become an investor on utility,
2 under the Federal Power Act and State utility codes, it
3 would remain fully subject to State and Federal regulatory
4 authority for all relevant issues, including cost allocation
5 and recovery.

6 If the plant is transferred to public ownership
7 beyond State or Federal ratemaking authority, then there may
8 well be a particular need for the NRC to establish
9 mechanisms to ensure that decommissioning expenses are
10 funded, but again, if the plant is transferred to another
11 private sector operator and if the plant continues to
12 provide power for sale at retail and/or wholesale, either
13 FERC, State commissions, or both will have jurisdiction to
14 regulate rates charged by the new operator.

15 It is true that under its KCP&L policy, the FERC
16 may approve market-based rather than cost-based wholesale
17 pricing, but the new operator would be fully subject to FERC
18 authority.

19 Agents to whether the NRC should require a new
20 owner of existing nuclear plant -- of an existing nuclear
21 plant to sign a binding agreement, holding it liable for
22 decommissioning costs, while I would have no objection to
23 such a requirement at this time, it is not clear how much
24 additional insurance, such as signed commitment, would
25 provide beyond the legal requirements imposed by the

1 statutes and regulations currently administered by the NRC.

2 There may be some benefit, however, is assigned
3 commitment clarifies the new operator's legal obligation to
4 decommission the transferred plant, whether or not the
5 revenues earned by the plant support the cost.

6 In closing, I would again commend the Commission
7 for undertaking today's conference. Clearly, it is critical
8 that the NRC closely monitor nuclear plant operators, as the
9 industry restructuring process proceeds.

10 Because it is now very early in the restructuring
11 process, there is no urgent need for the Commission to act
12 precipitously in response to industry changes.

13 Accordingly, while it is always appropriate for a
14 regulatory body to monitor conditions in regulated
15 industries, in light of evolving regulatory policies and
16 practices, broad revisions to NRC regulations at this time
17 would probably be premature.

18 The Commission should be attentive to developments
19 at the FERC and the Congress and its State legislatures and
20 commissions to get a clearer picture of how these changes
21 could affect nuclear safety issues.

22 Of course, the NRC, the FERC, and State
23 commissions should continue to work together closely to
24 address issues and problems of mutual concern.

25 Speaking for the NARUC, we stand ready to assist

1 in ensuring an effective dialogue through our more formal
2 participation in NRC administrative proceedings and
3 informally through gatherings such as this.

4 Again, thank you for your time and attention.

5 CHAIRMAN JACKSON: Dr. Draper?

6 DR. DRAPER: Thank you, Chairman Jackson and
7 Commissioner Rogers, for the opportunity to be here.

8 By far, the most important thing I can say this
9 morning is that I represent myself only, American Electric
10 Power, and not the several tens of -- nuclear licensees who
11 have very different situations, whose chief executives have
12 very different views. This is a time of considerable change
13 in the electric utility business, as has been pointed out
14 earlier.

15 Competition is here in the wholesale business.
16 Whether it comes in the retail business is a matter of
17 considerable discussion and speculation. Clearly, some of
18 my colleagues favor competition, some oppose, and some are
19 waiting to see what occurs.

20 So, as I speak, I wish to emphasize that I speak
21 for myself and AEP and not my colleagues.

22 It is quite clear that the effects of competition
23 in the wholesale market have captured the attention of the
24 electric utility business and the operators of nuclear
25 powerplants.

1 In the last three years, we have worked very hard
2 to improve the performance of those plants. The capacity
3 factors have increased by over 5 percent. The operation and
4 maintenance costs have been reduced by more than 4 percent
5 for an aggregate savings to our customers of over \$250
6 million, and I would argue that those savings reflect not a
7 lessening of safety, but rather, an improvement in the
8 performance of the plants.

9 By any measure, whether it is the INPO ratings,
10 the number of significant events, or any other measure of
11 the safe operation of nuclear plants, they have, in fact,
12 improved in the last three years, and I expect that
13 improvement to continue.

14 There are a wide variety of things that affect the
15 cost of operating the nuclear plant, not the least of which
16 is the Nuclear Regulatory Commission rules.

17 At this very time, there is discussion on Capitol
18 Hill of legislation that would deal with nuclear waste, and
19 clearly, that is an important issue not only for the cost of
20 operating nuclear plants, but it has an impact on the
21 ultimate decommissioning cost of those plants, depending on
22 how quickly or how slowly the nuclear waste can be moved off
23 site.

24 There are a number of things that are occurring in
25 the industry in the various States at the Federal level that

1 I think the NRC is wise to watch, and I congratulate you on
2 having this hearing to focus on those issues.

3 I would suggest to you that it is perhaps
4 premature to have a formal rulemaking at the Nuclear
5 Regulatory Commission, but of course, that is your decision.
6 If you should choose to do so, the nuclear industry would be
7 pleased to respond.

8 I think that by recognition of the fact that these
9 issues are important is reflected by the fact that the
10 Nuclear Energy Institute has recently formed a task force of
11 executives to begin to discuss these issues of deregulation
12 and competition and what the impact of that will be on the
13 business, and I am ceratin that the Nuclear Energy Institute
14 would be willing to participate in any proceedings that you
15 should schedule.

16 I would like to emphasize that it is the firm
17 commitment of all the chief executives, and here, I believe
18 I can speak for the industry, that it is important that we
19 as a group ensure the safe operation of all nuclear plants.

20 Despite the fervor for competition in the
21 wholesale markets and the discussions in the retail markets,
22 it is quite clear that we have pledged to each other that we
23 will continue to share information that will ensure the safe
24 performance of the nuclear plants. We recognize that each
25 of us is, to a considerable extent, hostage to his fellow

1 nuclear operators, and it is important to us that the plants
2 operate safely.

3 We have talked some already today about the issue
4 of stranded costs. Clearly, there are at least potentially
5 costs that would be stranded in a fully competitive market.
6 Moody's has estimated that those costs might be as high as
7 \$300 billion. It seems to me that, while that is not
8 directly the purview of the Nuclear Regulatory Commission,
9 you were wise to focus on that issue and what impact it
10 might have on the cost of decommissioning or the ability of
11 a nuclear operator to decommission a plant.

12 There are clearly licensing issues in the
13 restructuring of the electric utility industry. If there
14 are no longer vertically integrated electric utilities, then
15 the transfer of licenses should be of considerable concern
16 to you, if those licenses go to an entity that does not have
17 financial wherewithal to assure decommissioning and disposal
18 of spent fuel.

19 On the other hand, if there are proposals to
20 combine utilities that will make a stronger entity, it seems
21 to me that that is something that you should relish because,
22 in fact, that would give greater assurance that, in fact,
23 those costs could be borne.

24 It seems to me that in any proposal for
25 combinations or restructuring, you should not insist on the

1 removal of risk. By that, I mean you shouldn't establish a
2 practice of insisting on more quickly collecting the funds
3 for decommissioning activities because, in fact, that might
4 have the reverse consequence of making plants that were
5 formerly competitive uncompetitive as the prices rise.

6 As we have heard, the Federal Energy Regulatory
7 Commission has underway a proceeding, a Notice of Proposed
8 Rulemaking, which has stated the proposition that stranded
9 costs should be recovered, and it seems to me that that
10 should give you comfort.

11 In summary, it seems to me that this is an
12 important issue; that the Commission should follow it
13 carefully. You should differentiate in your thinking
14 between those plants that are above market-priced plants
15 because of investment, which can be dealt with in stranded
16 costs proceedings, as opposed to those plants that might be
17 above market price because of their production costs. That
18 is quite a different matter, and that is one that you ought,
19 I believe, give careful consideration.

20 In closing, I would like to reiterate my firm
21 conviction that nuclear plants are now safer than they have
22 ever been. It is certainly the objective of those who are
23 in charge of the operation of nuclear plants in the electric
24 utility industry to see that that safety performance does
25 not deteriorate, but in fact, produce.

1 CHAIRMAN JACKSON: Thank you.

2 Ms. Byrd?

3 MR. BYRD: Good morning. I address you as a
4 representative of investors in the electric utility
5 industry; that is, the owners and lenders to this important
6 segment of our economy.

7 I have the unique viewpoint from having served on
8 the Advisory Council of INPO for seven years and from
9 currently serving as a financial communities representative
10 on NEI's Nuclear Economics and Nuclear Fuel Advisory
11 Committee.

12 My firm, Morgan Stanley, is one of the most active
13 investment banks utilities. Over the years, we have
14 consistently been one of the leading underwriters for
15 electric utilities, and we are involved in much of the
16 financing associated with our Nation's nuclear units.

17 Recently, we have been very active advising
18 utility companies on financial issues relating to changes
19 occurring in the industry. As we all know, this is a very
20 dynamic time for the electric industry. The environment is
21 changing quickly. The full effects of this change are not
22 yet known.

23 From our point of view, the industry is responding
24 appropriately. We see new ways of thinking, new resources
25 being applied. Electric companies are addressing issues

1 head on. They are thinking more like competitive
2 businesses. Managements are restructuring, reorganizing.
3 They are looking at value-enhancing mergers and acquisition
4 opportunities.

5 Regulators are also changing significantly. At
6 least 30 States are at various stages of proceedings to look
7 at these issues and address specific circumstances in their
8 regions. The FERC is taking a leadership role. We see a
9 tremendous commitment of resources with a goal of producing
10 consistent, well-grounded public policy.

11 Chair Moler and Commissioner Gee today have
12 addressed these changes in detail and are best equipped to
13 answer your questions on regulatory issues.

14 The financial community is placing a lot of focus
15 on this transition. The electric industry is the last and
16 largest U.S. investor-owned industry to be deregulated. The
17 outcome and timing are very uncertain. As a result, the
18 financial markets are watching very carefully.

19 Initially, the markets reacted forcefully to the
20 threat of deregulation and competition. As time has passed,
21 however, these markets have become more reasoned. Witness
22 of recent record stock prices for many electric companies.

23 To date, there have been encouraging signs from
24 Federal and State policymakers that this transition to a
25 deregulated environment will be orderly and thoughtful.

1 As a result, the current view of more and more
2 investors is that this industry will have more control over
3 its destiny than many had originally feared.

4 The financial community is encouraged by FERC's
5 constructive, responsible approach. FERC has demonstrated
6 its understanding of the importance of certainty and
7 predictability during this transition period. The
8 Commission appears to recognize the needs of investors, and
9 perhaps more importantly, our Nation's need for a flexible,
10 competitive electric utility industry which continues to
11 have financial integrity and flexibility.

12 The subject of stranded cost is of particular
13 concern to nuclear utilities and their investors because it
14 is the sheer magnitude of dollars associated with these
15 above-market capital costs.

16 FERC has clearly indicated its view that costs
17 which become stranded during the transition to competition
18 will be fully recoverable, assuming they are legitimate and
19 verifiable. It appropriately wants utilities to do
20 everything they can to mitigate the impact of stranded
21 costs, and the industry appears willing to accept this
22 challenge.

23 State actions, of course, will be important since
24 they regulate the bulk of revenues. The general view of the
25 financial community is that there will be a considerable

1 period of time until we fully know the future of electricity
2 markets in the U.S.

3 In these briefings today, the NRC is asking what
4 role it should play in this evolving world. To start with,
5 dialogues such as this is certainly valuable and should be
6 continued. It is important that the NRC understand the
7 changes that are occurring.

8 Our general view, however, is that actions by the
9 NRC at this time are not necessary. The rules for the
10 transition are far from known. As a result, it is
11 impossible at this time to make judgment as to your
12 appropriate actions.

13 From the point of view of the financial community,
14 any actions at this time from the NRC would be premature and
15 potentially harmful. In fact, some of the actions that the
16 NRC might take, including many of those referred in the
17 Commission's questions, could contribute to increasing cost
18 for nuclear generation, have the effect of driving the
19 industry to be uncompetitive, without any positive impact on
20 the safety of nuclear generation.

21 Speaking of safety, I think it is important to
22 emphasize that, although often unstated, investors do assume
23 and require that safety remains the highest priority of
24 nuclear operations.

25 Investors want the value of the assets behind

1 their investments to be maintained. They require that
2 managements of their companies safeguard their investments,
3 since any nuclear safety problem can have significant
4 investment implications.

5 At the same time, the financial community wants
6 its nuclear investments to be efficient and electric, and as
7 Linn has stated, the industry has demonstrated that this is
8 not contradictory to maintaining the highest standards of
9 safety.

10 Investors are very aware of the progress that has
11 been made at improving the operations, production costs, and
12 safety trends of nuclear generation.

13 Looking forward, there is the expectation that
14 there is still room for increasing the cost effectiveness of
15 nuclear generation. There remains significant cost
16 differences among units. The industry through INPO has
17 adopted some ambitious goals, its year 2000 challenges,
18 which should help to improve the competitiveness of the
19 nuclear industry.

20 Contrary to what some feared, sharing among
21 nuclear units has increased, not decreased, as competition
22 is intensifying. This has been aided by the clear
23 recognition that nuclear companies remain captive of each
24 other. Problems at one nuclear unit, not only safety, but
25 also electric, can have a domino effect on all nuclear

1 units.

2 We have seen the NEI industry-wide benchmarking,
3 the operating alliances, such as the utility service
4 alliance, and the sharing of good operating practices.
5 These are viewed as having the potential for both reducing
6 costs and improving safety for the industry.

7 I point these efforts out to counter the argument
8 that nuclear generation cannot be competitive in the
9 evolving electricity marketplace. Based on both current,
10 but especially potential future trends, the production costs
11 of nuclear generation clearly can be one of the least
12 expensive forms of generation.

13 In a competitive world, generation will be
14 dispatched on the basis of price which reflects production
15 costs, incremental marginal costs. That will be key.

16 As a result, there is no reason to assume that
17 nuclear generation in a fully competitive market will be
18 shut down, especially if this generation can produce the
19 improvements potentially available from increased capacity
20 factors and cost control.

21 As you all know, the real problem for nuclear
22 utilities is the capital costs, and that is what is creating
23 the major issues as we move on in competitive markets.
24 Traditionally, the way to bring down capital costs was to
25 depreciate a plant over its remaining life. We are,

1 however, not in a traditional environment.

2 Investors have financed this generation with the
3 expectation that they would get a return of this investment
4 through the depreciation charge over the life of the units.
5 Much alternative generation is now available or can be built
6 which can produce electricity with significantly lower
7 capital costs. It is this problem which creates the
8 significant concerns for investors, but while this is
9 extremely important to the financial community, it is an
10 economic regulatory issue, not a safety or NRC issue.

11 Assuming utilities are provided to the opportunity
12 to recover stranded costs over a reasonable time frame,
13 nuclear generation should remain viable.

14 With that background, I'd like to comment briefly
15 on three areas addressed in the Commission's questions,
16 specifically on the implications of the changing environment
17 on the NRC's financial assurances requirements, the area of
18 license transfer, and finally, the NRC's requirements for
19 the funding of decommissioning cost.

20 First, the financial assurances requirements. As
21 we know, the NRC has in place a comprehensive, effective
22 program to monitor safety and takes actions, if necessary.
23 This program has included a review of the financial
24 qualifications of all nuclear operators. From the financial
25 markets perspective, this authority is very strong and has

1 been sufficient to assure the protection of health and
2 safety.

3 From our point of view, there is no reason to
4 assume that a higher level of financial assurance is
5 necessary just because markets are becoming more
6 competitive. The NRC should not undertake new financial
7 qualification rules before a clear understanding of the new
8 competitive environment exists. To develop new rules before
9 then would be premature and would only add financial
10 uncertainty, potentially driving up cost for nuclear
11 generation.

12 Utility companies will need flexibility, including
13 from the NRC to participate effectively and efficiently in
14 competitive energy markets, while upholding high standards
15 of safety.

16 Second, license transfer. As has been mentioned
17 earlier, it is likely that new ownership structures will
18 occur as the industry moves into a more competitive
19 environment. It is too early to see clearly how this change
20 will evolve. We do expect that structures will vary widely
21 and there will not be one formula for all.

22 You have already seen the move by some companies
23 towards functional unbundling and nuclear operating
24 companies within existing corporate entities. We have also
25 seen the creation of larger, fully integrated companies

1 through the merger of existing utilities.

2 The next step for some companies could be
3 structural unbundling and disaggregation with the formation
4 of new freestanding generation companies.

5 I would emphasize, however, that there are
6 numerous complex issues which will have to be addressed
7 before this can be accomplished. Many, although not all of
8 these structures, will require nuclear license transfers
9 which will come before you for approval.

10 We would expect that any new corporate entities
11 seeking nuclear license transfers will be ready to commit to
12 ensure safety and maintain high levels of expenditures
13 appropriate for safe maintenance and operations of nuclear
14 units and to provide for decommissioning.

15 From the point of view of investors in these
16 entities, it would be helpful to have a clear understanding
17 of NRC guidelines for transfer of license, especially in the
18 cases where generation will be sold into non-cost-of-service
19 environments.

20 Although it is not yet necessary for NRC to act in
21 this area, I would encourage you to begin talking with the
22 industry about your requirements for license transfer to
23 generation entities when and if this comes before you.

24 It may then be appropriate to address each
25 situation on a case-by-case basis within the context of

1 broadly defined requirements.

2 Third, decommissioning requirements. Several of
3 the Commission's questions related to the possibility of new
4 rules for decommissioning reserves coming out of the changes
5 in the utility marketplace. In your questions, you have
6 suggested accelerating collection to shorter periods,
7 captive insurance pools, binding agreements for the payment
8 of decommissioning costs. Such proposals are an example of
9 actions of which from the financial community's point of
10 view would be seen as overreaction and potentially
11 counterproductive to what the Commission is trying to
12 accomplish.

13 Of particular concern to us would be the concept
14 of accelerating decommissioning funding for all plants, so
15 this would be completed in 10 years or some other shortened
16 period.

17 Such a requirement would not only increase sharply
18 the cost of decommissioning, accentuating the competitive
19 problems of nuclear generation, it could also be seen as an
20 indication from the NRC of its view of the electric life of
21 nuclear generation contributing to problems for the
22 industry.

23 We recognize NRC's concern that decommissioning be
24 provided for in any environment, especially if nuclear units
25 are prematurely closed for any reason, including competitive

1 pressures.

2 In answer to another of the Commission's
3 questions, I would say that we do not forecast a widespread
4 closing of nuclear units in the U.S., especially if the
5 positive trends in production costs continue as in recent
6 years.

7 Even if there are some early shutdowns, the
8 regulatory issues associated with such shutdowns have
9 already been addressed by the NRC, FERC, and State
10 regulators in connection with plants such as San Onofre I,
11 Trojan, and Yankee Rowe.

12 The NRC has demonstrated in these cases that it
13 has ample authority to assure a safe shutdown and
14 decommissioning. There has never been a serious question as
15 to the NRC's authority in this regard, and decommissioning
16 will not alter this authority, and deregulation will not
17 alter this authority.

18 Also, the economic regulators have consistently
19 ruled that the cost of decommissioning should be collected
20 from customers. If there is further concern about
21 assurances of adequate decommissioning reserves, we think
22 this would be better addressed by the FERC and State
23 regulators.

24 From our point of view, this is a prudent and
25 necessary cost that should be collected from all customers,

1 preferably as part of the cost of using the transmission
2 system.

3 Such a collection would be consistent with the
4 concept of stranded cost recovery contained in the FERC's
5 MEGANOPR. By collecting decommissioning costs using the
6 transmission system, the public health and safety objectives
7 of the NRC would be satisfied and the impact on each
8 customer would be very modest.

9 In conclusion, I thank you for this opportunity to
10 represent the financial community at this briefing. We have
11 seen positive changes from the NRC in recent years. I
12 believe that your goal and ours as investors is similar, the
13 safe and effective operations of nuclear generation.

14 I am sure that these goals will continue to be
15 consistent as we move into a new and more competitive market
16 place. We encourage the NRC to continue its dialogue on
17 changes in the electric industry. Although we do not
18 believe that actions are appropriate at this time, this may
19 change, and we think that NRC will have ample time to act.

20 To the extent that the financial markets get
21 appropriate messages from electric as well as safety
22 regulators, I am confident that the nuclear industry will
23 remain a viable one in which the financial community will
24 continue to invest.

25 CHAIRMAN JACKSON: Thank you.

1 I would like to thank all of you for sharing what
2 I know is very valuable time with us this morning.

3 I would like to begin by directing a question to
4 Chair Moler and to Commissioner Gee, and to some extent, it
5 may be going back over some ground that you touched on in
6 your remarks, but the object here is to flush them out and
7 to flush them out a little bit more.

8 Mr. Gee, I noted in your speech that you felt it
9 was important -- that you thought on the one hand the
10 Commission should not act precipitously, and, Chair Moler,
11 you indicated the importance for FERC to ensure a fair and
12 orderly transition from regulation to competition, and that
13 utilities should be able to seek recovery of some
14 investments and other costs that have been prudently
15 incurred, and I think you also used the terminology
16 "legitimate" and "verifiable" costs, and I think that you
17 have made it clear, the FERC's position.

18 I think you have indicated, Commissioner Gee, that
19 you think because of the evolving landscape that it is
20 important that the NRC not be precipitous, although I must
21 say if one reads the various publicly available statements,
22 there is not necessarily consistency in perspective as to
23 the recovery issues of stranded costs.

24 So I guess my real question has to do with
25 definition of prudence and what you see as a good operable

1 way of thinking about that, and I am also asking that if it
2 appears that in the landscape the stranded cost issue is not
3 being dealt with -- and you focussed on wholesale issues and
4 then pointed out the State's primacy in the retail area --
5 but if, in fact, there begins to develop evidence that there
6 isn't going to be some overall methodology for dealing with
7 this, one idea that has come under discussion is for some of
8 this question of stranded costs to be dealt with at the
9 Federal level.

10 So I am interested in getting your feedback on
11 that and whether you feel, for instance, a recognition of
12 decommissioning costs is a good candidate. I know that is a
13 very broad kind of question, but I am interested in hearing
14 your views on prudence and decommissioning costs being dealt
15 with at the Federal level.

16 MR. GEE: You go first.

17 MS. MOLER: Our rule, as you have recognized,
18 gives utilities an opportunity to recover prudently incurred
19 costs. We would then go on to say they have to be
20 legitimate and verifiable.

21 Basically, that means that if the cost recovery is
22 challenged, I would expect a hearing, for us to hold a
23 hearing, and utilities would have to show their books and
24 records to verify that these costs, in fact, have been
25 incurred and that they are honest-to-goodness costs incurred

1 in constructing a powerplant or what have you.

2 We have had a great deal of experience on this
3 subject as we have gone through a transition in the natural
4 gas industry for natural gas pipelines for whom we did
5 provide cost recovery very similar to what we have proposed
6 for electric utilities in their transition to competition.

7 We have held a gas pipeline seeking to recover
8 costs submit their rate cases to us, their cost recovery
9 proposals to us where they have been challenged on the issue
10 of prudence. We have established hearings, and we have not
11 made disallowances on the basis of prudence to date in the
12 gas pipeline area.

13 In some cases, we have disallowed particular cost
14 recoveries because they couldn't show us the costs to our
15 satisfaction, and that is where the legitimate verifiable,
16 show us your stuff, books and records terminology comes
17 from.

18 I would not expect large disallowances of nuclear
19 powerplant investments, for example, as a result of this. I
20 think these plants have been built. They are operating. We
21 know that.

22 I certainly would not expect in any way, shape, or
23 form to have disallowances of decommissioning monies that
24 are required pursuant to your regulations.

25 CHAIRMAN JACKSON: Thank you.

1 MR. GEE: At the State level, let me speak both on
2 behalf of what NARUC has done as an organization to
3 encourage its States to look at stranded costs and also
4 specifically as to what I sense may be happening in
5 individual States.

6 As an organization, NARUC has encouraged its State
7 members, State commission members, to address the stranded
8 costs question in any instance of either retail competition
9 being introduced into their markets or in situations of
10 municipalization by a previous retail-level customer, and I
11 would anticipate that the vast majority of States behave
12 responsibly in inquiring into what the effects of uneconomic
13 investment would be and who should bear that cost
14 responsibility if competition is introduced.

15 In fact, I think it would be very, very unlikely
16 that the question would not be addressed in a very
17 responsible way, and I think that all State commissioners,
18 if I can try to speak on their behalf, intend to act
19 responsibly and try to reach a fair and equitable outcome.

20 Right now at the State level, it is premature
21 because we don't have any set standard or no States have
22 implemented on a broad-scale basis general standards for
23 recoupment of cost.

24 There have been some specific instances in
25 individual States on some smaller companies where there have

1 been some interim decisions. I think Massachusetts had an
2 instance where there was an indication of adopting a 75
3 percent/25 percent sharing plan for recoupment of cost by a
4 utility that was threatening to lose one of its industrial
5 customers, one of its institutional customers, but even that
6 is not necessarily a barometer of what may happen on a
7 State-by-State basis.

8 I also think that there are other alternatives in
9 the restructuring debate to simply passing through costs of
10 uneconomic investment as it may pertain to nuclear capacity.
11 Certainly, one proposal that I have heard being discussed
12 is, perhaps, nuclear generation ought to be viewed
13 differently from other sources of generation. If to the
14 extent we deem it to have some environmentally benign
15 impact, perhaps it might be better characterized as
16 something that would qualify for special treatment, and that
17 the costs associated with maintaining the operation of that
18 capacity should be treated differently and not be subject to
19 competitive forces, or perhaps having, say, a commonly
20 established funding mechanism through a wires charge on the
21 distribution grid. That already is being discussed with
22 respect to renewables capacity, and it is not unlikely, I'm
23 sure, that those same types of questions will be raised with
24 respect to nuclear capacity in individual States.

25 I think that also would address, Chair Jackson,

1 your question about decommissioning costs. If you assume
2 that the decommissioning costs are an operating expense that
3 ought to be legitimately recovered by current ratepayers,
4 there ought to be no reason why the decommissioning costs
5 ought to be treated any differently from the current
6 operation and maintenance cost of the enterprise, whatever
7 we decide to do.

8 CHAIRMAN JACKSON: I am a poor nuclear safety
9 regulator, and I guess I want to be sure that I understand
10 from the point of view of how your statement of how the
11 stranded costs are to be dealt with flows into what
12 Commissioner Gee is saying, when in the end you are both
13 talking about nuclear powerplants from our perspective and
14 related issues. Can you enlighten me a little bit?

15 MS. MOLER: It is a complex area. Utilities
16 allocate basically their costs according to wholesale and
17 retail sales. They do rates that we are responsible for,
18 file rate cases with us to recover, and we approve rates to
19 recover the wholesale portion.

20 Mr. Gee and his colleagues do retail.

21 CHAIRMAN JACKSON: We know.

22 MS. MOLER: We have said in our rulemaking
23 proposal that if the full recovery of assets is not
24 immediately possible on a competitive basis that we will, as
25 part of restructuring, charge any customer that is proposing

1 to leave, propose this system, its mathematical share, if
2 you will, of the uneconomic costs that a utility has.

3 That proposal is not uniform across the country
4 with respect to retail cost recovery.

5 As Mr. Gee has said, we are in a sense ahead of
6 many of the States, several States that are near making a
7 decision on cost recovery for any transition if they are
8 going to go to retail wheeling or direct access as its new
9 nomenclature is, but some States have proposed significant
10 cost absorption.

11 CHAIRMAN JACKSON: All right.

12 MR. GEE: I think it is important to understand
13 that there are some States that I would consider to be
14 vanguard States that are looking into retail competition
15 much more aggressively, although even there, the timetable
16 for implementation is, as I said, being phased in.

17 For the vast majority of States, we really haven't
18 addressed or have not made decisions yet on how to recoup
19 uneconomic investments.

20 In fact, in my own State, we are just now
21 beginning the process of opening up a docket to take
22 information, and we are going to be filing a report with the
23 legislature by the end of next year. So it will be some
24 time if or when we do arrive at some form of calculation,
25 primarily because we are going to be looking for legislative

1 guidance from our State legislature to determine whether or
2 if we are going to open up our markets to retail
3 competition.

4 I think it is fair to say that in many States,
5 except for a select few where they are nearing decisions,
6 most States right now are still in the process of
7 undertaking sort of a generic evaluation of the benefits of
8 competition and are not at the point of making a cut on how
9 those costs ought to be absorbed or allocated or shared.

10 CHAIRMAN JACKSON: I notice, Dr. Draper and Ms.
11 Byrd, that you have been busily making a few notes.

12 What options do you view as viable means that
13 utilities have available to deal with stranded costs?

14 DR. DRAPER: Well, I think that both Chair Moler
15 and Commissioner Gee have spoken to the suggestions that
16 people have made; that is, charging exit fees, putting the
17 costs, so to speak, on the wires, so that all customers who
18 use the distribution system would pay a share of those
19 costs.

20 It seems to me that the most desirable way to deal
21 with the issue, of course, is to be sure that the plants
22 operate, so that the produce is priced at a level that it
23 will not only cover the production cost, but also recover
24 the return on and of the investment in the plant.

25 Utilities are seeking in every way they know how

1 to arrange their business so that happens. By that, I mean
2 they are clearly driving down the production cost of the
3 plants. In many cases, utilities have approached the retail
4 commissions and proposed depreciating the plant more rapidly
5 so that those costs get off the books more quickly than they
6 traditionally would have done.

7 It seems to me that we ought to at least give that
8 system a chance to work. We should expect that the costs of
9 the nuclear production will go down as time goes on. We
10 should expect that the retail commissions will act
11 responsibly, and to the extent that they do those things, I
12 think the number of problems will be small.

13 MR. BYRD: We do see utilities wanting to be in
14 control of their destiny, and I think the efforts to have a
15 system that companies can work under and at the same time,
16 particularly focussing on production costs and other costs,
17 try to get down their costs and have this as a way to
18 mitigate some of the problems that they don't want to raise
19 rates.

20 CHAIRMAN JACKSON: So none of you see any need or
21 desire to have any aspect of this beyond what has been
22 already discussed by Chair Moler, but again, coming back to
23 the decommissioning cost issue to be dealt with at the
24 Federal level.

25 DR. DRAPER: I would agree with that, at least at

1 the moment. I think it would be premature for the NRC to
2 take any action at this time. I think you should pay
3 attention. Clearly, it is an issue that has the potential
4 for affecting people's ability to decommission a plant
5 safely, and you ought to watch the proceedings both at the
6 Federal level and in the several States, but I think it
7 would be premature to take action, particularly since a
8 number of those actions might, in fact, make the problem
9 worse.

10 CHAIRMAN JACKSON: Ms. Byrd, what do you see as --
11 I am putting you on the spot -- any probabilities of any
12 bankruptcies coming out of this restructuring?

13 DR. DRAPER: I can't wait to hear you on this.

14 MR. BYRD: It is certainly not something that the
15 investor wants to see, and I don't think any regulator or
16 Federal policymaker does either.

17 We have had two bankruptcies in the last 10 years
18 for the industry. They have been very difficult times, and
19 I think the all-out effort from all parties will be not to
20 have any others.

21 MR. GEE: Could I also address that as well? In
22 our State, we had one of those bankruptcies, the El Paso
23 Electric Company that owned a share of a nuclear generating
24 plant. The bankruptcy had no effect on the operation.

25 CHAIRMAN JACKSON: How much did they own of the

1 plant?

2 MR. GEE: I don't know the exact percentage. I'm
3 probably going to be wrong. I think it was probably around
4 20 percent of Palo Verde, but their financial distress, to
5 my understanding, did not understand the integrity and
6 safety of the plant, nor did it persuade at one time a
7 prospective suitor from seeking to acquire El Paso Electric
8 as well.

9 In fact, the utility continued to operate under
10 bankruptcy and service continues to be provided today while
11 it is still in bankruptcy.

12 MR. BYRD: Just for completion, the other
13 bankruptcy also involved a nuclear utility, the Public
14 Service of New Hampshire. The Seabrook Plant continued to
15 function safely.

16 MS. MOLER: Chairman Jackson, at some risk, let me
17 state that one of the reasons we have been so concerned
18 about stranded cost recovery is inherent in your question.

19 There are very significant dollars at risk in
20 this, as Mr. Draper intimated. The high-end number is \$300
21 billion. The total amount of costs that we have passed
22 through in the restructuring of the natural gas industry is
23 around \$10 billion. So there are huge, in orders of
24 magnitude, differences here.

25 So it is a serious issue. I have been on a soap

1 box for a couple of years on the stranded cost recovery
2 issue. It is not a popular position to take because, of
3 course, it does take a longer period of time until
4 individuals and businesses recognize lower rates and pay
5 less for electricity, but it is possible to restructure the
6 industry, pay for the stranded cost, and still have lower
7 rates in the bargain. It just takes longer.

8 CHAIRMAN JACKSON: Well, let me just undergird my
9 question, so you understand my concern.

10 Obviously, I'm very aware. In fact, I asked the
11 Staff here recently to get the figures together for me on
12 the net investment of the utility plant in the nuclear area,
13 and I think it is a very sensitive and serious issue.

14 We have had unfortunate bankruptcies, and in our
15 materials area, we have had licensees for whom
16 decommissioning funding was not adequately addressed, who
17 later were bankrupt, and we're still left with dealing with
18 some of those issues. I don't anticipate that kind of a
19 situation in the electric utility industry, but it is
20 something that one has to be concerned about.

21 Let me go on and ask you a few other questions,
22 and then I would like to give Commissioner Rogers his chance
23 to get a few oars into the water.

24 Are you aware of any NRC-imposed antitrust
25 conditions that are inconsistent, Chair Moler, with the

1 pro-competitive initiative such as your MEGANOPR?

2 MS. MOLER: I am not personally familiar with all
3 of the NRC-imposed antitrust conditions. I am ont aware
4 that that has been raised in our docket, but I simply don't
5 know, one way or the other. I will be happy to check into
6 it, but it hasn't reached my consciousness.

7 CHAIRMAN JACKSON: I would like to go back on
8 something that Ms. Byrd talked about.

9 How likely is it that an increase in the required
10 decommissioning of funding or an acceleration of that would
11 have an impact that is significant enough to make a nuclear
12 utility less competitive?

13 In some sense, one could argue that compared to
14 the overall revenue generated and other costs that these
15 costs are really not that large, although irrespective of
16 their importance at the other end for decommission.

17 Would you care to comment, and Dr. Draper?

18 MR. BYRD: And I have not done the statistical
19 analysis to know if you were to shorten it to a time period.
20 The margins are not that broad between being competitive and
21 not. So I think you would have to really look at the
22 numbers.

23 Have you?

24 DR. DRAPER: Not really, but I think we, among us,
25 can figure it out, at least part of it out.

1 The contribution to a decommissioning fund for a
2 plant whose decommissioning cost is several hundred million
3 dollars is several tens of millions dollars a year, and the
4 operating and maintenance cost of nuclear plants is less
5 than 100 million typically. So it is a nontrivial, not
6 dominant, but nontrivial component of the annual cost of the
7 production at the nuclear plant.

8 To the extent that Caren is right, and I think she
9 is, that competition will be in a fairly narrow band of
10 price, that could be decisive. So it is something that
11 should not be dismissed as a small number compared to the
12 total revenues of the utility or compared to the investment
13 in the nuclear plant. It is really the running cost of the
14 plant that matters, and when you scale it to that, it is
15 significant.

16 CHAIRMAN JACKSON: You noted that the Commission
17 may need to address how specific aspects of its licensing
18 requirements might be implemented in a situation where the
19 generating plants are not part of a vertically integrated
20 utility, and I think, Dr. Draper, you mentioned that.

21 Where do you find there to be particular
22 vulnerabilities in this area?

23 DR. DRAPER: It was a question to me?

24 CHAIRMAN JACKSON: Well, the two of you.

25 DR. DRAPER: Well, I think the issue would be if

1 one had a transferrable license from the vertically
2 integrated utility that had some assurance of a revenue
3 stream to an entity that was a generator, whether it was a
4 stand-alone nuclear generator or in combination with other
5 generation capability, and by change of circumstance,
6 perhaps, that entity became noncompetitive, then there would
7 be no wherewithal to pay the decommissioning costs.

8 So it would seem to me that if the proposition
9 were to make a license transfer from a vertically integrated
10 utility that considerable care would have to be given to the
11 analysis to be sure that the generating entity would be
12 viable over the long run.

13 That is quite a different circumstance, it seems
14 to me, from the prospect of transferring a license from a
15 vertically integrated utility to a merged pair or trio of
16 vertically integrated utilities who, presumably, are coming
17 together because it would financially strengthen the various
18 parties.

19 So, in a merger situation where the resultant
20 would be an entity that was better, it seems to me that you
21 ought to be considerably more relaxed about that than the
22 circumstance you might be faced with to license an entity
23 that was simply a generator.

24 CHAIRMAN JACKSON: Mr. Gee, you mentioned a number
25 of alternatives relative to decommissioning funding, at

1 least in your submitted statement, as well as in some of you
2 remarks; for instance, the insurance alternative. Tell me a
3 little more about what you see as some kind of an equitable
4 financing mechanism.

5 MR. GEE: I was addressing the question that was
6 posed to me by your letter of invitation that talked about
7 what the feasibility would be of perhaps setting up a common
8 insurance pool to ensure or to provide ample funds,
9 instances of unanticipated shutdowns of plants for
10 decommissioning costs.

11 The only available current mechanism I am aware of
12 is the NEIL organization whose purpose is to provide
13 insurance in case of catastrophic events.

14 My suggestion is that you perhaps should consult
15 with that organization to see whether it would be feasible
16 to arrange for a common type of insurance mechanism such as
17 NEIL to provide funds for instances of premature
18 decommissioning, assuming you have a situation where you
19 don't have a succession of plants that are prematurely shut
20 down.

21 As I understand it, the NEIL pool is available,
22 and it anticipates only in very limited instances, if at
23 all, of any form of catastrophic events. Otherwise, that
24 pool would be depleted, but that is one avenue that you
25 should probably undertake with the private sector to look

1 into, if that is what your interest is, looking at other
2 available mechanisms.

3 DR. DRAPER: It seems to me that the difficulty
4 with insurance, if it really is insurance, is that in a
5 typical insurance situation, people are trying to protect
6 against a risk that can be determined actuarially among
7 entities that are at least somewhat similarly situated.

8 In the case of the NEIL insurance, the presumption
9 is that most nuclear plants have about the same chance of
10 calling on the insurance pool as others, and to the extent
11 that that is not true, in fact, you are typically given a
12 lower insurance premium if your plant performs better, if
13 your INPO rating is better, et cetera.

14 The difficulty with the decommissioning issue is
15 that plants are not similarly situated. You know which ones
16 are high-cost producers and which ones are the low-cost
17 producers, and to the extent that you have an assessment on
18 all producers, what you are really doing is taking funds
19 from the customers, presumably, of the low-cost plants and
20 transferring that wealth to the shareholders, perhaps, of
21 the high-cost plants.

22 So it is clearly not the normal insurance
23 situation. There might be some mechanism that could be
24 convected, but it would fall outside what I would call a
25 normal insurance situation. Well, the assigned risk pool,

1 of course, is a little bit simpler.

2 CHAIRMAN JACKSON: Commissioner Rogers, do you
3 have any questions? I am not done, but I shouldn't dominate
4 the conversation.

5 COMMISSIONER ROGERS: No, no. That is all right.
6 I think that many of my questions are getting asked and
7 answered very satisfactorily.

8 Let me just thank you all very much for being with
9 us. This may be a first for us of having this group with
10 the NRC together at one time.

11 I know at the last NARUC meeting, the session that
12 you folks were all at, it was claimed to be a first of its
13 kind there, and maybe this is a first of its kind here.

14 I think it is a very positive way to proceed. We
15 must keep each other informed on these issues. They are
16 complex, and certainly, NRC's interest in safety is not an
17 electric one, but we know that the economics do come in and
18 have an effect.

19 I have not many questions. I have a few comments.
20 I think it is very interesting to see the extent to which
21 you do all agree that this is not the time for NRC to move
22 quickly on new regulations in this area. That is important
23 for us to have your perception.

24 On the other hand, you did say that the situation
25 is uncertain. It is moving. No one knows exactly how

1 rapidly it is going to move, and it is going to move through
2 a complex series of events.

3 My concern is more stranded responsibility than
4 stranded costs. I think that it isn't always a question of
5 just dollars. It is who can you hold responsible in the
6 end, and one of the problems that I see is that in this
7 period of change, and perhaps rapid change, although not
8 universally consistent, something happened someplace that we
9 don't quite understand, and all of a sudden, we don't know
10 who to hold responsible.

11 That is a problem that I see because I think we
12 have seen some evidence of something like that developing in
13 the materials area, and with corporate restructuring and
14 many complicated moves that might take place -- and these
15 are not done in a fishbowl, so that everybody can see what
16 is happening -- we are concerned, and I know I am concerned
17 and I am sure the Chairman as well, that somehow we don't
18 find ourselves in a situation that when we come to hold
19 someone accountable, it isn't clear who that is anymore.

20 I think that is a problem that I don't think
21 anything you have said today has helped me very much with in
22 the sense that it could happen, and that is why I think it
23 is so important that we stay in a constant dialogue to try
24 to assess what the probability or possibility of sort of
25 thing happening is.

1 In the operating area, I totally agree with Dr.
2 Draper and Chair Moler that there really is no incentive, in
3 a sense, for operators to cut costs and cut corners because
4 high efficiency does go with high safety. We have seen
5 that. There is just no question about it that the plants
6 that are most efficient are also the safest ones, and the
7 ones that are most costly are the ones that we worry about
8 most from a safety point of view.

9 So there is strong incentive on the part of the
10 operators, I think, to do a very good job, and that will
11 result in efficiency and safety. Both will go together.

12 So I am personally not so concerned about the
13 safety consequences of these moves in the industry with
14 respect to operations, although we have to watch very
15 carefully, certainly not relax, but nevertheless, I am less
16 fundamentally worried about that than I am about the end
17 result that comes about when there is no source of income to
18 support things like decommissioning, when suddenly
19 everything has disappeared.

20 A \$5 billion asset becomes a \$1 liability
21 overnight. Then where do the funds come from if that
22 happens suddenly in some way? That is what we are concerned
23 about, and we need your help and your thoughts to help guide
24 our thinking on this.

25 I think your written submissions and, certainly,

1 oral submissions here today have been very helpful. There
2 have been a number of, I think, very helpful comments, one
3 with respect to don't go too fast on something when your
4 headlights don't tell you where the road is, and I think
5 that that is something that is a good cautionary note. I
6 think that is probably where we are right now in this
7 matter.

8 Nevertheless, it is an area that we must pay
9 particular attention to for the future. We have talked
10 about decommissioning costs, but you know decommissioning
11 costs have a lot of uncertainties associated with them.

12 The cost of low-level waste disposal has got a big
13 unknown associated with it, and of course, storage of spent
14 fuel may be an additional cost as well that have
15 uncertainties.

16 The actual cost of decommissioning a plant, I
17 think, while we at NRC have done analyses that haven't
18 differed too much from our earlier projections, I don't
19 know. There is a technology evolving there that still has
20 some questions associated with it that could lead perhaps to
21 less cost, but on the other hand, there might be some
22 problems that we don't anticipate that could increase those
23 costs.

24 So I am not so sanguine about what those
25 decommissioning costs actually will turn out to be in any

1 particular circumstance, and I am happy to hear that you are
2 thinking about the need to provide for them, but I am not
3 sure that we really know what ultimately they are going to
4 be in all of the situations.

5 I do think that suggestions with respect to things
6 that we might look into are very helpful. I think they
7 really are some good ideas for us.

8 I do have a question for Dr. Draper, though. In
9 your written comment, the Chairman asked a question on it,
10 but I don't think she pursued it quite as far as we might,
11 and that has to do with the antitrust requirements, the
12 Atomic Energy Act.

13 In your written submission, you strongly
14 encouraged us to consider eliminating those requirements
15 from existing operating licenses, and I wonder where you see
16 the biggest problems arising from the existence of those
17 requirements.

18 DR. DRAPER: Well, I am not sure that I really am
19 qualified as a non-attorney to speak in detail about that,
20 but it seems to me that there have been a number of things
21 done in the development of the nuclear industry that were
22 done in the name of antitrust that have caused problems,
23 particularly in the past with respect to the ownership of
24 plants where there were entities who wished to own a piece
25 of a nuclear plant and as an issue in the antitrust

1 proceedings they were allowed. The investor-owned utility
2 typically was forced to allow minority partners to
3 participate in the plant, and that has in a number of cases
4 led to rancor and acrimony with respect not only to the
5 economics of the plant, but with respect to the operation of
6 the plant.

7 I think those sorts of things are probably not
8 helpful.

9 CHAIRMAN JACKSON: Well, also, I could ask a
10 million questions, but I would like to thank all of you for
11 coming.

12 Commissioner Rogers is more direct than I am in
13 the following sense. The decommissioning costs as one
14 element of our discussion represents a liability for the
15 time being, and that was part of my discussion in trying to
16 get Chair Moler and Commissioner Gee to make some comment.
17 Each person has his assignment of the wholesale versus the
18 retail part, but in the end, you have an asset on the
19 ground, as it were, and the question becomes how does that
20 get dealt with and that it doesn't fall between the cracks.

21 You mentioned, Ms. Byrd, the issue of the fact
22 that our regulations give us strength and we review the
23 financial health and financial assurance for nuclear plants.
24 The truth of the matter is that entities that have been
25 defined as electric utilities in our regulations, which

1 means economically regulated, at the operating license stage
2 have, in fact, not gotten the kind of financial review that
3 you are talking about that does occur when there is a new
4 entity coming on line, and it may be an issue of exercising
5 more diligently and carefully existing regulations in cases
6 that may come before us as the industry restructures, but I
7 wanted to make that point that existing electric utilities
8 and those defined as such in our regulations have not gotten
9 that kind of review because of the assumption that they had
10 economically guaranteed rates of return which gave us
11 comfort that they had the resources both to be operated
12 safely, as well as the fact that decommissioning trust fund
13 costs were explicitly dealt with as part of that.

14 So what I am saying to you is that as that goes
15 away or if it goes away, it is something both in the
16 financial assurance area overall, and we are not financial
17 regulators, but we do have to have levels of comfort that
18 the resources are there.

19 If as that goes away as the kind of structures
20 that were anticipated at the time that early reviews were
21 done, change would disappear, then we have to be sure that
22 from the perspective of our requirements that these
23 liabilities and these issues do not get lost as the baton
24 gets passed from one set of stakeholders in this to another.

25 In the end, we would not like to be left with a

1 situation where things end up having to be punted over to a
2 Super Fund or becomes a taxpayer liability overall. So
3 there is an overall financial prudence that is part of this,
4 as well as the health and safety aspects.

5 I heard, together with Commissioner Rogers, your
6 very strong message about not being precipitous. At the
7 same time, we would not like to find ourselves in the
8 position of trying to catch the train after it has left the
9 station. So that is part of why I do appreciate your coming
10 and why I think these sorts of dialogues are very important
11 and will continue.

12 We are looking at our regulations and regulatory
13 processes not looking to be precipitous. We think a further
14 evaluation of these issues is required prior to be able to
15 make meaningful conclusions, but as deregulation continues
16 to evolve and the electric environment that utilities
17 operate in becomes more clearly defined, then I think that
18 we will be looking more specifically at the adequacy of our
19 regulations, and again, the particular area of focus has
20 been the decommissioning funding, particularly with the
21 possibility of a premature shutdown that may be driven by
22 other than economic requirements that we might put into
23 place in this area, but again, our primary focus always
24 remains high safety standards and that adequate resources
25 are devoted to that, and in the end of the useful life of

1 the plant, however that is defined, that it can be safely
2 and completely decommissioned.

3 Unless Commissioner Rogers has any further
4 comments --

5 COMMISSIONER ROGERS: No. No, thank you.

6 CHAIRMAN JACKSON: -- I would like to thank you
7 again.

8 We are now adjourned.

9 COMMISSIONER ROGERS: Thank you very much.

10 MR. GEE: Thank you.

11 MR. BYRD: Thank you.

12 [Whereupon, at 11:38 a.m., the meeting was
13 concluded.]

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CERTIFICATE

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

TITLE OF MEETING: BRIEFING ON ELECTRIC UTILITY INDUSTRY
RESTRUCTURING AND DEREGULATION -
PUBLIC MEETING

PLACE OF MEETING: Rockville, Maryland

DATE OF MEETING: Thursday, December 14, 1995

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

Transcriber: Jeanne Malloy

Reporter: Mark Mahoney

STATEMENT BY
ELIZABETH A. MOLER, CHAIR
FEDERAL ENERGY REGULATORY COMMISSION

BEFORE THE
NUCLEAR REGULATORY COMMISSION

December 14, 1995

Chairman Jackson and Commissioner Rogers:

Thank you for the opportunity to be here this morning to discuss with you issues surrounding the restructuring of the electric industry.

Under the Federal Power Act and the Energy Policy Act of 1992, the Federal Energy Regulatory Commission regulates the rates and terms of service for wholesale sales of electric energy in interstate commerce and for interstate electric transmission. Our principal statutory objectives are to ensure that rates and services are non-discriminatory and provided at just and reasonable rates.

Today I would like to discuss the significant changes that have occurred in the electric industry since the Energy Policy Act was passed three years ago and the regulatory initiatives the Commission has underway to ensure a smooth transition to competition. I will also attempt to identify the more important electric issues facing us in the near future.

The Commission is making major strides in developing competitive wholesale power markets under the regulatory framework that Congress has provided in the Federal Power Act and the Energy Policy Act. Our goal is simple: We want to guarantee all power generators non-discriminatory access to transmission lines so that buyers and sellers can get together and competitive wholesale power markets can flourish. These markets ultimately will bring lower electricity rates to the Nation's consumers.

There are three major points I want to emphasize:

- ° First, all consumers should be able to reap the benefits of competitively priced generation. Open access transmission is the key to developing a competitive industry. Those who control the Nation's transmission grid must be required to provide non-discriminatory access to all wholesale sellers and buyers of electric energy. The Commission is in the midst of a major rulemaking initiative that will make wholesale open access a reality.
- ° Second, we at the FERC must ensure a fair and orderly transition from regulation to competition. We learned from our experience in the natural gas area that it is critical to give utilities the opportunity to recover the costs they incurred to serve their customers under

the old rules. Wholesale stranded cost recovery is inextricably linked to the Commission's open access rulemaking initiative. Open access will not succeed without a fair transition cost mechanism.

- ° Third, in addressing open access and stranded costs, the Commission has proposed, and will take, no action inimical to the safety or reliability of the Nation's nuclear plants.

Changes Following the Energy Policy Act of 1992

The electric utility industry is today an industry in transition. In response to changes in the law, technology, and markets, competitive pressures are steadily building. Today, new generation facilities can produce power at a cost of about 3 to 5 cents per kilowatt, yet consumers in some regions of the country are paying 9 to 11 cents per kilowatt. Not surprisingly, these consumers want access to the cheaper sources of power. And those sources want access to the market. Once the domain of large, vertically integrated utilities providing power at regulated rates, the industry now includes companies able and willing to sell "unbundled" power at rates set by competitive markets.

In the Energy Policy Act of 1992, Congress gave the Commission authority to order wholesale transmission services on

a case-by-case basis under section 211 of the Federal Power Act. It also gave a "green light" for new entrants in the generation sector of the electric power business. These new entrants, known as exempt wholesale generators or "EWGs", need to meet relatively simple requirements for the FERC's approval; once approved, they can generate and sell power free from the strictures of Public Utility Holding Company Act.

The impact of these changes has been enormous. Consistent with Congress' clear intent in the Energy Policy Act to encourage competitive wholesale power markets, the Commission has aggressively exercised its new authority. We have now approved 255 EWG applications. We also have 16 cases in progress where someone is seeking a transmission order under the new section 211.

As the Commission began implementing the new electric provisions, however, it soon became clear that we needed to use our other regulatory tools under the Federal Power Act to make wholesale competition work. Competitive pressures have grown faster than any of us anticipated. Wholesale buyers wanted access to cheaper power. Wholesale sellers wanted the ability to compete on a fair basis. Buyers and sellers complained that transmission owning utilities were treating themselves better than their customers. It became apparent that better transmission service is essential. Section 211 is a useful tool

for handling specific disputes over access. However, it is procedurally too complex to deal with the demands of the market for open access on an industry-wide basis.

Last year in a case involving the AEP Companies, the Commission ruled that public utilities may not give themselves a preference over third parties wishing to use their transmission wires. The "Golden Rule of Comparability" was born. Since then the Commission has applied the comparability rule to a broad range of cases, including mergers and requests for market-based generation rates, as well as open access transmission filings.

The Commission set for hearing a number of cases and charged the parties with figuring out how to make the comparability requirement work. As we progressed, however, utilities began asking the Commission to define the comparability principle in greater detail. Many were willing to comply; but they needed better guidance from the Commission about what type of transmission tariffs would be acceptable to us. It also became apparent that the only way to remedy existing discriminatory practices is to act generically. In addition, the Commission became concerned about the need to provide a smooth transition through these competitive changes.

As a result, on March 29, 1995, the Commission issued a notice of proposed rulemaking that would require utilities

subject to our jurisdiction to provide open access transmission services and also would deal with the issue of stranded costs.

Open Access/Stranded Cost Rulemaking Proposal

The proposed rulemaking would require all public utilities to provide access to their transmission wires on an open, non-discriminatory basis. It provides sample or pro forma open access tariffs that contain the minimum terms and conditions of good access. It also requires that rates be comparable. In addition, the rulemaking proposes that utilities functionally "unbundle" their services. This means that they must separately price generation, transmission and ancillary services, and that the transmission owner take service under its own tariff. For those who are not subject to the Commission's jurisdiction under the Federal Power Act, the Commission is proposing a reciprocity requirement; if the non-jurisdictional utilities want to use a jurisdictional utility's open access, they must offer open access in exchange.

The rulemaking also proposes to allow electric utilities to seek recovery of stranded costs. These costs are the sunk investments and other costs that a utility prudently incurred to serve its existing customers. As the Commission stated in its stranded cost proposal, the electric utility industry has billions of dollars invested in utility assets and contracts that, in today's markets, may become uneconomic. If wholesale or

retail customers leave their utilities' systems without paying a share of these costs, the costs will become stranded unless they can be recovered either from the departing customers or other customers. These costs were incurred under a regulatory system that imposed on utilities an obligation to serve -- an explicit obligation at retail and the expectation of a requirement to serve in wholesale transactions -- based on the history of supplier-buyer relationships.

The proposed regulatory framework permits recovery of all prudently incurred costs. Moreover, while there has always been some risk of a utility losing a customer, that risk has been greatly increased by significant statutory, regulatory, technological, and structural changes in the industry -- changes that utilities may not have foreseen at the time their investments were made.

In the proposed rulemaking, the Commission stated its belief that utilities that made large capital expenditures or long-term contractual commitments to buy power many years ago should not now be held responsible for failing to foresee such fundamental changes in the industry. We stated that we will not ignore the effects of regulatory and statutory changes on the past investment decisions of utilities. We believe that equity requires that utilities have an opportunity to recover legitimate

and verifiable stranded costs associated with the development of competitive wholesale markets.

I want to make clear that this opportunity extends to any nuclear power generation assets that may be stranded in the competitive market place. Our proposal is "fuel neutral". We make no distinction as to the type of generation for which stranded cost recovery may apply. Thus, investments in nuclear plants, as well as the decommissioning costs associated with those investments, could be recovered.

I also want to point out that the majority of any stranded costs would not be the result of FERC-required wholesale open access. This is because most utility costs, over 80 percent, are incurred serving retail rather than wholesale customers. Therefore, most stranded costs would be the result of a state regulatory commission's requirements that a utility provide direct access, or retail wheeling, which would permit its retail customers to reach other power suppliers.

Retail wheeling is in the hands of the states because the Energy Policy Act explicitly forbids the Commission from ordering retail wheeling. If utilities are to recover costs stranded by retail wheeling, such recovery must be through jurisdictional mechanisms available to the states. The Commission's rulemaking proposes a way to delineate where we have jurisdiction under the

Federal Power Act and where states are in charge, so that costs stranded by retail wheeling can be recovered through a charge on local distribution facilities subject to state jurisdiction.

Perhaps most importantly, I believe that our decision to deal immediately and comprehensively with stranded costs as an essential element of our open access initiative will serve as a model for the states. Our informal discussions with state regulators who are pursuing retail wheeling initiatives have been reassuring in this regard.

Since we issued our proposed rule, there have been other developments in the competitive world. The California Public Utilities Commission has issued proposals for retail competition. Twenty-nine other states are now exploring options for addressing electric restructuring issues. However, it is too early to tell where these experiments and investigations will lead.

The Commission's rulemaking does not propose to restructure the electric industry. It does not propose abrogation of contracts or the disaggregation of assets. It does not propose to require corporate reorganization along the functional lines of generation, transmission and distribution. Many commenters have urged us to take on these broader restructuring issues, and these are issues we will have to consider.

In that regard, the approach we are proposing differs from that taken in the gas area. However, the electric industry is at a very different stage than the gas industry was when the Commission issued its gas restructuring initiative, known as Order No. 636. The commodity or wellhead natural gas market was already competitive at the time we issued the gas initiative, whereas electric generation is not yet competitive. In addition, when we issued Order No. 636, most gas was already being sold on an unbundled basis; this is not true in the electric industry. Ultimately, the Commission must tailor its approach to fit the circumstances existing in today's electric utility industry.

At this juncture, let me state plainly and unequivocally that nothing we propose affects the safety or reliability of the transmission or generation of the Nation's electric power. We at the Federal Energy Regulatory Commission take seriously our obligation to act in the public interest.

The response to the NOPR has been phenomenal. We have received over 20,000 pages of comments from about 400 commenters. The Commission has begun the task of analyzing the comments and refining its proposed rules. In addition, we have held technical conferences with all industry participants to help us. These conferences have focused on ancillary services, the pro forma tariffs, and on power pools. The Commission has also held an open, on the record dialogue on the rulemaking with our state

regulatory colleagues. And, although not required to do so, we are developing an Environmental Impact Statement for the proposed rules.

The Commission is working hard to encourage utilities to file open access tariffs before we put generic rules in place. As encouragement, we have provided easier filing requirements, less case-by-case litigation and earlier approvals for things like market-based rates for power sales. In response, many utilities have already filed open access tariffs. When we issued the NOPR last March, 21 electric systems had filed some form of open access tariff with us. We now have more than doubled that number with a total of 48 electric systems that have filed some form of open access tariff. This includes several of the original 21 that have refiled improved tariffs. To date, we have accepted 38 of these tariffs. A large number of these tariffs offer the high quality transmission service that would be required under the proposed pro forma tariffs.

We consider our open access initiatives, even though not complete, to be a success story in the making. Many progressive utilities are beginning to see the advantages of open access to the benefit of consumers. We still have a long way to go, but the industry has made real progress.

To date, we have not received any indication from the many participants, including state regulators, that the proposed rules, if implemented, would threaten the safety or reliability of nuclear plants. Nor would I expect any. We establish rates and we order transmission access. Our proposal does not touch existing state or federal laws or regulations involving safety or licensing matters.

To be sure, there is the claim raised by some in our proceedings that competition, in driving managers to cut costs, will drive management to cut corners. We will, of course, respond to these comments in the course of our proceeding. But, let me give you my personal observation on this issue.

We do assume that competitive pressures will improve efficiencies. Indeed, competition is here now and we have seen this happen. However, to assume that safety or reliability will be compromised as a result is to assume utility executives will break the law and state and federal regulators will relax enforcement. I believe this is a wholly untenable assumption. To the extent that wholesale competition affects the marketability of power from nuclear plants, I am confident that our stranded cost policies will provide the utilities with the means to provide responsibly for reliability and safety concerns.

Near-Term Issues

As the Commission works through the comments to a final open access rule, there are four broad issues facing us. First, what are the right terms and conditions for open access? Second, what safeguards are necessary to ensure nondiscriminatory access? Third, have we drawn the jurisdictional bounds properly, as both a legal and a policy matter, between the Commission and the states? Finally, have we developed the right method for determining stranded costs, and what stranded costs should be covered? The Commission is working diligently toward resolving these issues.

The Commission's long-term goal is to remove regulation where we can rely on competition to discipline market power. For some time, we have been permitting market-based rates for generation where we find that the power supplier does not have market power. However, parts of the electric industry -- most prominently transmission and some existing generation markets -- are not competitive and must continue to be regulated. For these, I hope we can improve our approach to regulating them. Over time, I expect wholesale generation markets to become fully competitive. While transmission is likely to remain a natural monopoly, there are many ways we can change our regulation to better accommodate competitive generation markets. That includes innovative transmission pricing. In this regard, we have issued

a transmission pricing policy statement to encourage utilities to make such innovative proposals.

Once the Commission successfully addresses the issues of open access transmission and stranded costs, there are other issues on which we will need to focus to ensure that wholesale competition works and that our Nation's electricity ratepayers are protected. We must ensure that our standards for market-based generation rates and utility mergers are appropriate, and that we can effectively monitor affiliate abuse.

We have a lot of work ahead of us, but I believe Congress has given us a solid set of regulatory tools under the Federal Power Act and the Energy Policy Act to help bring about a fair transition for wholesale competition in electricity and to ensure that such competition works effectively to the benefit of electricity consumers.

Summary

The electric utility industry is well on the road toward the development of competitive bulk power markets that will more efficiently and effectively serve the needs of the Nation's electric consumers. The key components of achieving competition are open access transmission services for all wholesale sellers and buyers of electric energy and the fair allocation of the stranded costs that can result from the transition to

competition. We are using the tools Congress gave us to effectively address these issues in a manner that does not compromise safety or reliability.

As for your questions on the regulation and maintenance of nuclear plants, these are matters beyond our jurisdiction. We have responsibility only over a very narrow class of generation. Under Part I of the Federal Power Act, the Federal Energy Regulatory Commission licenses privately-owned hydropower projects. This is the only type of generation plant that we license. Fortunately, we are not required to regulate safety or reliability issues for nuclear power plants. We leave that responsibility in your capable hands. Consequently, I must defer to others as to questions in these areas.

December 10, 1995

NRC BRIEFING ON INDUSTRY RESTRUCTURING AND DEREGULATION

Caren Byrd, Morgan Stanley

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**STATEMENT BY
COMMISSIONER ROBERT GEE
PUBLIC UTILITY COMMISSION OF TEXAS
AND
CHAIR, NARUC COMMITTEE ON ELECTRICITY

BEFORE
U.S. NUCLEAR REGULATORY COMMISSION

DECEMBER 14, 1995**

Chairman Jackson and Commissioner Rogers:

I greatly appreciate the NRC's invitation to appear at today's briefing on electric utility industry restructuring and deregulation. While I am Chair of the Committee on Electricity of the National Association of Regulatory Utility Commissioners (NARUC), unless specifically noted, I do not appear here today as a spokesman for NARUC.

I strongly commend the Commission for undertaking today's conference. During this period of fundamental change in the structure and operation of utility systems, it is critical that the industry's economic regulators -- State commissions and the FERC -- and nuclear safety regulators -- the NRC -- maintain a continuing dialogue to ensure that the transition to greater competition does not compromise safety or reliability. My NARUC colleagues and I look forward to an effective working relationship with both the FERC and the NRC as the restructuring debate continues.

Questions concerning the restructuring and deregulation of the electric utility industry are being debated today in Washington and in State capitals, prompted primarily by three factors: (1) the 1992 enactment of the Energy Policy Act (EPAct) which promoted the development of independent wholesale power producers through exemption from the Public Utility Holding Company Act (PUHCA) and the opportunity to access new bulk power markets through

transmission access orders issued by the FERC under a revised section 211 of the Federal Power Act, (2) the FERC's subsequent proposal to issue generic rules that require utilities to provide unbundled transmission services under tariff on a system-wide basis (i.e., the "MEGANOPR"), and (3) proposals and final decisions in State commissions and legislatures to permit retail customers to choose alternate sources of power generation to be delivered to them via "retail wheeling."

Because the great majority of electric services (over 80%) are provided at retail subject to State regulation, industry restructuring will evolve on a State-by-State basis, unless Congress enacts legislation adopting a national model. As a result, States are taking a variety of approaches to restructuring/deregulation issues. A recent report found that "more than half of the states have started serious investigations of restructuring issues."¹ This report noted that "[t]welve. . . states have issued or are about to issue reports on their findings." In addition to commission investigations, State legislatures have also become involved in enacting legislation to facilitate restructuring.

The kinds of initiatives the States are considering include customer choice through retail wheeling, rate reform through the adoption of performance-based ratemaking structures (PBR) and economic development rates, and elimination of exclusive retail service territories. However, I would anticipate that States will proceed cautiously in each of these areas, using

¹ Robertson's Current Analysis, October 1995, at 1. This report's conclusions are generally consistent with another survey conducted by the National Council on Competition and the Electric Industry, a joint partnership between the NARUC and the NCSL to assist States in their consideration of restructuring issues.

small scale experiments in customer choice (e.g., Michigan), or phasing in retail wheeling through pilot programs (e.g., New Hampshire).

While it is very early in this process of change, there are discernible trends at work, at least at the general level: first, I would expect that utilities will be required to offer services competitively at both wholesale and (in some States) retail on an unbundled basis. This will require changes to the integrated structure of the electric utilities (in which generation, transmission and distribution services are provided as a package). The form this could take ranges from functional unbundling, wherein a utility offers services priced and provided separately (this is the option proposed by FERC for wholesale services in the MEGANOPR), to corporate restructuring, wherein the utility establishes separate corporate subsidiaries to provide generation, transmission and/or distribution services, to more comprehensive structural reform involving spin offs of ownership of generation, transmission and/or distribution facilities.

The second general area of change involves the implementation of market-based pricing policies. For its part, the FERC has declared that newly acquired wholesale generation is now competitive, and accordingly, need no longer be regulated on a cost-of-service basis under the Federal Power Act. While few if any States have authorized market-based pricing for retail services at this time, implementation of retail customer choice could result in movement from a tariff-based system to a system based on contracts between power suppliers and customers, presumably at market. In addition, as I mentioned, States are now experimenting with alternative ratemaking approaches for retail utility sales that depart from traditional cost-of-service methodologies. The purpose of these reforms is to create ratemaking incentives for a utility to improve the efficiency of its operations. For example, PBR proposals permit utilities

to retain some of the benefits of their efforts to reduce costs. One possible outcome is that current rate disparities between utilities would be reduced as rates converge toward a market-determined regional average.

The third trend we observe is that open access wholesale transmission will accelerate the growing trend toward regionalism. Transmission planning will be conducted on regional basis, in some cases through regional transmission groups (RTGs). Power pools may be operated by independent system operators (ISOs) on a regionwide basis, and bulk power (wholesale) markets will be priced regionally. It will test the creativity of both State and Federal regulators to invent a workable institutional framework to match this important market development.

I know that the Commission is keenly interested in the pace at which these changes take place. If restructuring proceeds on a State-by-State "evolutionary" track -- which in my view is the prudent way we should proceed -- it could take at least 10 years before a majority of U.S. retail consumers are served by restructured electric service companies. Some States may reject restructuring entirely, favoring continuance of the vertically integrated, cost-of-service, exclusive service territory model. However, enactment of congressional legislation which takes decisionmaking out of State hands could accelerate and broaden retail restructuring.

While restructuring activities have moved quickly in wholesale markets regulated by the FERC, it is clear that we are in the "trial and error" stage at the retail level. I firmly believe diversity of State decisionmaking will be beneficial to the development and implementation of practicable policies. It is particularly important, in our view, that State commissions and legislatures be afforded substantial flexibility to experiment with alternative legislative and regulatory approaches to these critical issues.

Of course, one of the key considerations that State decisionmakers will be called upon to address with flexibility and creativity is the effect that industry restructuring initiatives might have upon utilities operating nuclear power plants. First, let me state unequivocally that each State regulator grappling with the changing utility industry fully understands the need to ensure that the safety and reliability of nuclear plant operations not be compromised in any way. We fully support the NRC's efforts to ensure that a utility industry made more efficient through the forces of competition remains a safe and reliable industry. In my view, the goals of improved efficiency through restructuring and continued safety are not incompatible.

In the remainder of my remarks, I would like to address two areas which I understand are of particular concern to the Commission: the effect of the "stranded cost" issue on utility operations including the likelihood of early plant shutdown, and decommissioning.

First, as to stranded cost recovery. Some utilities currently own nuclear plants (as well as non-nuclear assets) whose unrecovered value in utility rate base exceeds their value in the market at current prices. It is argued that greater competition from less expensive generation sources will expose these plants as uneconomic, forcing their owners to shut down operations. However, it is not necessarily the case that an action by a utility to write down the rate base value to the market value (and adjust prices accordingly) means that the plant will be shuttered. Once written down, such plants may be highly competitive due to their relatively low variable costs. Plants may be shut down earlier than expected, but for reasons other than uncompetitiveness, such as cost of repairs and retrofits (as in cases of Trojan and Yankee Rowe plants). As commonly understood, the "stranded costs" of nuclear plants are sunk costs already expended; shutdown will yield no savings to the utility for such costs.

Moreover, to address the question of who pays for the write downs, State commissions are now in the process of developing cost recovery mechanisms, such as non-bypassable, competitively neutral wires charges and exit fees, that fairly and effectively allocate stranded costs. Here again, we see no need for a one-size-fits-all approach to what is a very traditional regulatory question involving cost identification, allocation and rate design.

Turning to the second area of concern -- decommissioning -- I would not expect that the adoption of diverse regulatory policies by the State commissions and legislatures will necessarily make it more difficult for the NRC to continue to use generic decommissioning funding requirements. The fact that some States may authorize or require that utilities depart from cost-based ratemaking methodologies while others adhere to traditional policies does not mean that the NRC cannot issue regulations imposing an obligation on the nuclear utilities to adequately fund decommissioning and factor that expense into their revenue structures. The States and FERC will then bear the responsibility of seeing that legitimate costs of service are recoverable. If necessary, the NRC may wish to consider a regulatory approach that establishes options for compliance, rather than a single set of requirements.

However, in any reconsideration of its decommissioning policies, the Commission should be mindful of their competitive impact on the companies. For example, by raising costs, increases in decommissioning trust funding could make a utility less competitive, all things equal. Accordingly, to the extent that an increase in decommissioning funding raises the utility's variable costs to the point that the plant in question becomes uncompetitive (separate and apart from sunk cost recovery issues), it could be counterproductive for the NRC to increase this expense too far too fast.

Similarly, there may be some benefit to an NRC policy which requires that licensees recover their full decommissioning funding over the next ten years on the assumption that retail markets will not be fully competitive until then. Such a policy would be similar to the plans of some States (e.g., California) that are considering accelerating plant depreciation schedules to work off potentially straddle costs prior to full competition. As noted, the effect of accelerating the collection of decommissioning or plant costs is to increase a utility's costs, which may worsen its ability to compete. The insurance alternative discussed in the Commission's letter of invitation to today's conference may make more sense than accelerated decommission cost collection provided it is structured to spread the risk of unfunded decommissioning expenses more broadly, and thereby reduce the competitive harm that increased costs would have on an individual firm. I would suggest that this option be studied by the Commission in consultation with the industry's existing insurance programs.

In its list of questions, the Commission has also raised the matter of industry reorganization through mergers or asset transfers. To the extent that nuclear assets are now subject to State and Federal regulatory jurisdiction, their ownership cannot be transferred without the authorization of each affected State commission and the FERC. Provided that the entity to which a nuclear plant is transferred is or would become an investor-owned utility under the Federal Power Act and State utility codes, it would remain fully subject to State and Federal regulatory authority for all relevant issues including cost allocation and recovery. If the plant is transferred to public ownership beyond State or Federal ratemaking authority, then there may well be a particular need for the NRC to establish mechanisms to assure that decommissioning expenses are funded. But again, if the plant is transferred to another private sector operator,

and if the plant continues to provide power for sale at retail and/or wholesale, either FERC, State commissions or both will have jurisdiction to regulate rates charged by the new operator. It is true that under its KCP&L policy, the FERC may approve market-based (rather than cost-based) wholesale pricing, but the new operator would be fully subject to FERC authority.

As to whether the NRC should require a new owner of an existing nuclear plant to sign a binding agreement holding it liable for decommissioning costs: while I would have no objection to such a requirement at this time, it is not clear how much additional assurance such a signed commitment would provide beyond the legal requirements imposed by the statutes and regulations administered by the NRC. There may be some benefit, however, if a signed commitment clarifies the new operator's legal obligation to decommission the transferred plant, whether or not the revenues earned by the plant support the costs.

In closing, I would again commend the Commission for undertaking today's conference. Clearly, it is critical that the NRC closely monitor nuclear plant operators as the industry restructuring process proceeds. Because it is now very early in the restructuring process, there is no urgent need for the Commission to act precipitously in response to industry changes. Accordingly, while it is always appropriate for a regulatory body to monitor conditions in regulated industries in light of evolving regulatory policies and practices, broad revisions to NRC regulations at this time would be premature. The Commission should be attentive to developments at the FERC, in the Congress and in State legislatures and commissions to get a clearer picture of how these changes could affect nuclear safety issues.

Of course, the NRC, the FERC and the State commissions should continue to work together closely to address issues and problems of mutual concern. Speaking for the NARUC,

we stand ready to assist in ensuring an effective dialogue through our more formal participation in NRC administrative proceedings, and informally through gatherings such as this.

Thank you for your time and attention.

**Nuclear Regulatory Commission
December 14, 1995**

**Briefing on Industry Restructuring and Deregulation
E. Linn Draper
American Electric Power**

I. Opening Comments

- * I appreciate the Commission's initiative to hold this briefing and invite a panel that reflects a broad cross-section of views on the future shape of the electric utility industry. Given the dynamic and evolutionary nature of the changes occurring in the electric utility industry, I expect that this will be the first of many such Commission interactions.
- * I am here today in my capacity as Chairman, President and Chief Executive Officer of American Electric Power. The views I express are my own. Each nuclear utility CEO may have a different situation and, therefore, somewhat different views on this topic.
- * The Nuclear Energy Institute is forming an Executive Task Force to assess the implications of electric utility industry restructuring and deregulation on NRC licensing and regulatory requirements. I know that NEI, representing the industry, will work with the Commission to address the types of questions and issues we are discussing today.
- * You have heard from Chair Moler and Commissioner Gee about the broad scope of federal and state initiatives involving restructure of the electric utility industry. My remarks will focus on three topics today: 1) Economic Efficiency is Compatible with Safe Operation; 2) NRC's Approach to Regulation; and 3) Changes to NRC's Licensing Requirements.

II. Economic Efficiency is Compatible with Safe Operation

- * American Electric Power is working diligently to improve efficiency in our operations -- both fossil and nuclear -- and, in so doing, increasing our plant's output and reducing operating costs.
- * In fact, there has been significant industrywide success in this area. Over the past three years (1992-94), there has been an increase in nuclear capacity factor of 5.3 percent and a reduction in the operating and maintenance costs of 4.4 percent. That translates into an industrywide decrease in annual O&M dollars of about \$250 million.

- * During this same period, as an industry we have maintained steady improvement in all safety-related performance indicators.
- * And we, as an industry, are committed to continued improvement in the operating efficiency of our plants while still maintaining our excellent safety performance. This goal is clearly achievable.
- * Of particular importance to both of us -- as operators of nuclear plants and as regulators -- is that the plants with the lowest expenditures are generally also the best operating plants and have the best INPO and SALP ratings. Efficient operations and safety go hand-in-hand.
- * The success we have achieved as an industry in the area of safe operations is largely the result of industrywide sharing of good practices. That sharing will continue and is being expanded to help us operate more efficiently.
- * All nuclear utilities working with NEI, INPO and EPRI have developed a "Strategic Plan for Improved Economic Performance." The first major area in this plan addresses what the operators of nuclear plants can and should do to improve efficiency. Sharing good ideas and practices among the plants is a prerequisite. The industry is currently sharing such ideas through workshops, reference manuals and joint projects. As an example, American Electric Power is currently involved in an industrywide benchmarking project that will provide all of us with good practices from the best performing plants in engineering, operations, maintenance, training, rad waste/HP, outage management and work control.

III. NRC's Approach to Regulation

- * Now let me turn to the role of NRC regulation in the evolving world of a competitive electricity business.
- * We need the ability to satisfy NRC requirements in the most intelligent, efficient ways possible. However, the NRC should recognize that the utility industry is no longer one in which any cost which is imposed can necessarily be recovered and that in certain cases, NRC or others may cause nuclear plants to be closed prematurely for economic reasons.
- * The NRC should lend its voice and its technological expertise in urging Congress to find solutions to the high level and the low level nuclear waste storage problems. The

continued "non-solution" of these problems has resulted in projected costs for decommissioning to levels which are of concern whether utilities operate in a regulated or competitive environment. Solving the underlying problem would be more effective than increasing decommission funding requirements.

- * The precedent set by the maintenance rule, and the statements made by Chairman Jackson about risk-informed, performance-based regulation, are encouraging.
- * Both the Commission and the industry must find ways to use resources more efficiently, and I believe risk- and performance-based regulatory approaches provide a way to do that.
- * Continuing today's unnecessarily prescriptive regulatory regime will negatively affect our ability to compete effectively in the new electricity marketplace.

IV. Potential Changes to NRC's Licensing Requirements

- * Most of the questions contained in your letter to me were focused on what changes the NRC should consider making in its licensing requirements to accommodate, or respond to, the evolving competitive electricity marketplace.
- * First, let me say that the issue of industry structure is fluid, dynamic and fast changing. No one knows what the outcome will be, nor where or when changes will take place. I believe it would be premature and unnecessary for the commission to embark on rulemaking at this time. We need to have a clearer picture of how some of these issues play out.
- * Having said that, however, I can identify certain issues that may warrant discussion as we move forward.
- * I do believe it is appropriate and necessary for the commission have an ongoing dialogue with the industry as issues emerge. As I said earlier, NEI is forming an Executive Task Force to consider the implications of a restructured industry on NRC regulation, so NEI will be the best focal point for future interactions on these issues.
- * I don't believe that the NRC's or INPO's efforts to ensure safe operation will diminish. Nor will the legal requirements imposed on all licensees.

- * It is regularly stated that there will be "winners" and "losers" as competition develops in the industry, and that the high cost, inefficient producers will be the "losers." This does not necessarily mean financial collapse or an inability to finance costs of safe operation or decommissioning, but it does raise legitimate concerns for the NRC about the long-range effects on nuclear plants with high marginal costs of production.
- * Under certain assumptions about the nature of the future competitive paradigm, some nuclear units might be unable to compete successfully, not only so as to recover a return on and of investment, but even to fully recover marginal running costs. It is possible to envision a scenario in which the non-competitive status results in less and less utilization, increasing marginal costs even further, and ultimately causing temporary or extended cold reserve status, or even premature or early decommissioning.
- * Such situations may be remote at present, but they could become realities in some areas of the country as new competitive patterns begin to emerge. These problems may well be part of the social costs of such a revolutionary change in the structure of the industry, which need to be recognized in the appropriate measures to recover a form of stranded cost or accorded special treatment in the general public interest.
- * The issue of stranded cost on the part of nuclear utilities, estimated by Moodys to be as much as \$300 billion, is extremely important to electric utilities. While this issue does not fall directly under the purview of NRC, it is one of the factors which could have important effects on future financial strength of some companies.
- * At this stage, the industry's fluid state suggests that the NRC should continue to study developments in the industry and determine its position on these issues on a timetable that is consistent with the rate of change and direction of the emerging trends. This would suggest an increasing level of NRC participation and comment in the various regulatory and legislative forums which will be focusing on the related policy issues and proposals.
- * Given the premise that nuclear plants may not be subject to cost-of-service regulation, the questions raised in your letter about decommissioning costs and financial qualifications are clearly relevant and need to be addressed.

- * I believe that the Commission may need to address how specific aspects of its licensing requirements will be implemented in a situation where the generating plants are not part of a vertically integrated electric utility. It is not clear that this situation will occur in the near future, or in some cases at all. However, utilities, the investment community and other policy makers who are assessing business or policy decisions need a clear understanding of the NRC requirements that may be under development to address such a situation.
- * With regard to your questions concerning decommissioning costs and reorganizations, I believe that adding the requirement that a financial assurance mechanism to fully fund decommissioning in advance could be both costly and counterproductive. If NRC were to adopt such a standard, it seems unlikely that many entities owning nuclear plants would voluntarily propose any restructuring involving nuclear facilities even though the result could be a financially stronger and more viable entity.
- * However, if restructuring does involve the transfer of control of a nuclear power plant, I believe it would be reasonable and appropriate to require the new entity to become bound by all conditions of the license including decommissioning funding.
- * We would not expect NRC to permit ownership or operation of nuclear plants by entities not subject to the full scope of an operating license. Furthermore, the original owner/operator should not be released as a licensee or co-licensee unless the new entity can demonstrate a comparable, or higher, level of financial soundness.
- * It would seem more constructive for NRC to evaluate restructuring proposals on a case-by-case basis, from the perspective of whether the transaction is likely to enhance or diminish financial integrity of the licensee, operating practices or the ultimate adequacy and assurance of decommissioning funding. The NRC's objective should be to facilitate and support organizational changes which improve conditions from the public perspective rather than to condition approvals on the elimination of decommissioning funding risks.

- * Following the latter approach will more likely have the counter-productive consequence of increasing the risk of inadequate decommissioning funding by discouraging restructuring transactions which could have enhanced the prospects for decommissioning funding.
- * As for decommissioning cost collection, there is no need at this time to accelerate the collection of decommissioning funds. Accelerating funding would increase the relative cost of nuclear generation over the chosen time period (10 years for example). This could actually hasten the need for decommissioning funding even further, because some plants could not economically produce power because of the accelerated costs and be retired early.
- * The FERC's "Mega-NOPR" explicitly allows recovery of all reasonable and verifiable stranded costs, which includes decommissioning costs. There are several options to ensure collection of decommissioning costs, including the revenue loss approach.
- * It is important to note that funding of decommissioning costs is clearly consistent with the precedents set by FERC and a number of state commissions in situations where nuclear plants have shut down prematurely.
- * It may also be necessary to provide a mechanism to "true up" future estimates for decommissioning costs. In this context, NRC's approach to establishing site cleanup standards will have a real impact on decommissioning costs. I urge you to approach the setting of these standards in a reasonable and practical way.
- * With regard to financial qualification requirements, I do not believe that a competitive market necessarily mandates a general need for a higher level of financial assurance, but it may require a different NRC requirement. Specifically, for those future situations where nuclear generators are not operating under a cost-of-service regulatory structure, it may be appropriate to define the NRC financial requirement as the amount of money necessary to maintain a plant in a safe shutdown condition. The availability of funds to maintain safe shutdown could be assured by a guarantee as part

of any license transfer approved by the NRC. Such concepts should be the subject of ongoing discussions between the industry and the commission.

- * While the probability of needing the funds borders on zero, NRC and the industry may also need to address the Price-Anderson requirements for Secondary Financial Protection for nuclear generators not on a cost-of-service regulatory structure. In general, I do not believe this should be a major problem since the units that are operating generate significant revenue and, if they are not operating, their liability is significantly reduced. But in order to provide clarity to licensees, and to other interested parties, a review of the NRC requirement may be necessary.
- * In a similar area -- that of safety implications brought on by electric utility restructuring -- American Electric Power, and I believe all utilities in the country with operating nuclear plants, would certainly be willing to comment on any rulemaking that the NRC proposes. We are all committed to safe operation of our plants.
- * Finally, a number of plants have specific operating license conditions related to the antitrust requirement of the Atomic Energy Act. This is not the case for our plant, but if it were, it would be a cause for concern. I encourage the Commission to consider eliminating these requirements from the existing operating licenses.

V. Closing Comments

- * In closing, let me reiterate that the pursuit of economic efficiency at nuclear power plants is completely compatible with safe, reliable operation of those plants, and that the NRC's approach to regulation can improve both safety and economic efficiency. Conversely, regulatory policies which would adversely affect the financial strength of nuclear utilities would negatively affect nuclear safety and industry cooperation.
- * Although the ongoing debate over how best to

structure the electric power industry may have significant implications for NRC requirements and regulations, we believe it would be premature for the commission to undertake new rulemaking at this time. It is essential, however, that the commission and the industry maintain a dialogue over certain regulatory issues and licensing conditions as the debate proceeds.