



THE FIRST STATES

THE LEARNING CURVE ON STRANDED COST RECOVERY POLICIES

October 1998

INTRODUCTION

California and Massachusetts are widely recognized as two of the first states to pioneer the nationwide effort to restructure the electric utility industry. In both states, the process began with a much-watched regulatory inquiry on the merits of "customer choice" or "retail access," agreement by the major utilities to support change once they were assured the recovery of stranded costs on their terms, and the subsequent enactment of a conforming restructuring law by the state's legislature. But in each state, the restructuring law was challenged by public referendum. Supporters of both ballot initiatives, who are primarily consumer groups, opposed the generous stranded cost allowances and sought a fairer determination and allocation of these costs.

But twelve other states have also ordered electric industry restructuring and mandated retail access by a date certain. With the exception of New Hampshire, these other states are successfully proceeding with their implementation efforts. These states include both high-cost and low-cost utilities.

It is now evident that states are directly benefitting from the experiences of the first states and are using provisions in the restructuring laws of other states as models for their own legislative proposals. As a result, many of the more recent restructuring laws and regulations contain provisions that more fairly balance the interests of utility shareholders and ratepayers, arguably avoiding the public outcry that occurred in California and Massachusetts. This paper describes the evolution of state policies on stranded cost recovery, and for the benefit of states that have yet to act, recommends model legislative language specific to stranded cost issues adapted from provisions contained in the restructuring laws of the "first states."

IDENTIFICATION OF STRANDED COSTS

Most state restructuring laws specify a definition of stranded costs that limits or qualifies the types of costs that are eligible for recovery from customers. These limitations provide guidance to the state's regulatory commission (or public power entities, as appropriate) when that agency

STATES MANDATING ELECTRIC INDUSTRY RESTRUCTURING AND STATE-WIDE DATE CERTAIN

Arizona	December 31, 1998
California	March 31, 1998
Connecticut	July 1, 2000
Illinois	May 1, 2002
Maine	March 1, 2000
Massachusetts	March 1, 1998
Michigan	January 1, 2002
Montana	April 1, 2000
Nevada	December 31, 1999
New Hampshire	July 1, 1998
New York	December 31, 2001
Oklahoma	July 1, 2002
Pennsylvania	January 1, 2001
Rhode Island	January 1, 1998

NOTE: Michigan and New York are implementing retail access under regulatory orders only. In several states, the date in which retail access is allowed for all customers is being accelerated.

IDENTIFICATION OF QUALIFYING STRANDED COSTS

MODEL LEGISLATIVE LANGUAGE

Stranded Costs—(a) Stranded costs shall be defined as the verifiable, net difference between the book value of all prudently-incurred jurisdictional assets and obligations necessary to furnish electricity acquired or entered into prior to the enactment of this act, and the market value of those assets and obligations directly attributable to the introduction of competition. Such assets and obligations shall be limited to generation assets, generation-related regulatory assets, and purchased power contracts.

(b) In determining each qualifying stranded cost, the commission shall take into account:

- (1) The extent to which the utility was legally required to incur the specific costs;
- (2) The extent to which the market value of the assets and obligations of the utility exceeds the book value of the assets and obligations;
- (3) The effectiveness of a utility's efforts to increase the market value and realize the market value of any assets, and to decrease the costs of any obligations;
- (4) The extent to which rates previously established by the commission have compensated shareholders for the risk of not recovering the costs of assets and obligations; and
- (5) If the utility had the discretion to determine whether to incur or mitigate the costs, the conduct of the utility with respect to the costs of the assets and obligations when compared to other utilities and businesses with similar obligations and risks.

These provisions are adapted from the Nevada and Connecticut restructuring laws, and the Arizona commission's restructuring rules. The Arizona commission is a separate branch of government under that state's constitution, and its rules have the effect of law.

adjudicates the determination of each utility's qualifying stranded costs. The statutory guidance intends to ensure a fair and equitable disposition of stranded costs, and prohibit the over-recovery of such costs from ratepayers. Over-recovery can result in the subsidization of shareholders at the expense of ratepayers. The potentially huge cash infusion provided by stranded cost recovery policies can also endow an incumbent utility with a tremendous competitive advantage, compared to utilities with no stranded costs. As the president of one California utility candidly put it when announcing his company's intention to seek new acquisitions: "We are going to have a lot of free cash from stranded-asset recovery ... in the billion dollar range."¹

Stranded costs are usually limited to three general categories of assets and obligations:

- (1) Generation Assets,
- (2) Regulatory Assets, and
- (3) Purchased Power Contracts.

Regulatory assets are utility expenses which have not been recovered from customers, often to avoid an unpopular rate increase. Some utilities are allowed to earn a profit on the unrecovered balance of these costs. Many states limit stranded cost treatment of regulatory assets to generation-related regulatory assets because only generation services are being deregulated in state restructuring activities. Typically, qualifying stranded costs must be "legitimate," "verifiable," "prudent," and "unmitigable." Several states also require that the underlying asset remain *used and useful* to conform with each state's prior application of this regulatory standard.

Stranded cost recovery is also limited to the extent a utility was legally required to incur the

¹"ENOVA, Pacific Enterprises Unveil New Joint Venture," *California Energy Markets*, March 14, 1997, p. 10.

costs, and the utility's performance with respect to those costs compared to other utilities with similar obligations and risks. For example, one of the largest categories of stranded costs is the above-market costs associated with purchased power contracts. Some, but not all, of these contracts were the result of a requirement of a 1978 federal law, the Public Utility Regulatory Policies Act (PURPA). The stranded costs associated with power contracts with other utilities is more than double the value associated with contracts with non-utility generators. Utilities that did a better job negotiating contracts with non-utility generators, and thus minimizing adverse ratepayer impacts, should be assured a greater opportunity for any recovery of those costs. In almost all states where such contracts are a problem, the utilities are required to mitigate these liabilities by renegotiating or selling the contracts. Some states offer incentives to encourage renegotiation efforts by considering the utility's efforts to reduce the cost to ratepayers of such contracts when determining the amount of the utility's other qualifying stranded costs. One "unorthodox" proposal in Vermont would threaten a utility with bankruptcy in order to force suppliers (including Hydro Quebec) to renegotiate high-cost power contracts.

Finally, at least half of the states that are implementing retail access explicitly exempt from stranded cost classification (and recovery) any load loss attributable to normal business conditions or other risks that utilities routinely faced under traditional regulation. This includes the options to bypass a utility with on-site generation of electricity, municipalization, or fuel switching.

QUANTIFYING THE AMOUNT OF STRANDED COSTS

Rhode Island is the only state to have explicitly specified the amount of stranded cost recovery in legislation, although that amount may subsequently be adjusted by the state commission. In all other states, one or more provisions

QUANTIFICATION OF QUALIFYING STRANDED COSTS

MODEL LEGISLATIVE LANGUAGE

Calculation—(a) For each electric utility, the commission shall determine the sum of the following to the extent they qualify as stranded costs pursuant to section {insert}:

- (1) The book value of a utility's regulatory assets related to generation;
- (2) The difference between net plant investment associated with a utility's generation assets and the market value of the generation assets; and
- (3) The difference between future contract payments and the market value of a utility's purchased power contracts.

(b) The value of all generation-related assets and liabilities and purchased power contracts must be reasonably demonstrable and must be considered on a net basis, and methods for determining value must include but are not limited to:

- (1) Estimating future market values of electricity and ancillary services provided by the assets;
- (2) Appraisal by independent professionals; or
- (3) A competitive bid sale of the asset or the output of the asset.

The commission shall not approve a sale unless the sale price equals or exceeds the asset's book value, or minimum bid established by the commission for the asset, and the sale will result in a net benefit to ratepayers. The commission shall determine the minimum bid price for each nuclear generation asset by determining the future net cash flow that a nuclear generation asset of comparable technical characteristics that is prudently and efficiently managed would be expected to produce over its expected remaining useful life, discounted to a present value.

(c) Notwithstanding any other provision of this act, the commission shall not include any costs for obligations incurred on or after October 24, 1992 in a utility's stranded costs, except that the commission may include obligations incurred by a utility after {date of enactment} to reduce stranded costs.

These provisions are adapted from the Maine, Connecticut, and Montana restructuring laws.

**DIVESTITURE OF GENERATION
ASSETS
BY STATE, IN MEGAWATTS⁽¹⁾**

Arizona	1,992
California	19,272
Connecticut	4,744
Illinois	7,174
Maine	2,365
Massachusetts	10,815
Montana	1,543
Nevada	3,049
Oregon	3,527
Pennsylvania	7,569
Rhode Island	(2)
Vermont	(3)
Washington	1,127

TOTAL CAPACITY (MW) 77,510

NOTES: (1) Includes capacity and some purchased power contracts that have already been sold and are in the process of being sold or auctioned; (2) Rhode Island generation included in Massachusetts total because of joint ownership; (3) Amount of capacity yet to be announced

specifying a methodology, or guidelines for developing a methodology in a commission rulemaking, are codified in the restructuring law. In the two states which are implementing retail access without restructuring legislation (Michigan and New York), the method was part of a rulemaking and/or settlement process. In Michigan, this process is ongoing.

The most common method states have adopted for determining the amount of stranded costs associated with generation assets involves the divestiture of the assets to determine their fair market value. The market value is then compared with the asset's net book value to derive a preliminary estimate of the amount potentially "stranded" by competition. The preliminary stranded amount may then be subject to mitigation efforts or other conditions or considerations.

Generating units have been sold, offered for sale, or subject to an auction in eleven out of fourteen states that are presently implementing

restructuring. Utilities in three other states have also begun to sell off their generation assets. In some cases, the requirement to divest is a pre-condition to stranded cost recovery. For example, the Connecticut law requires utilities to submit their nuclear generation assets to a public auction "held in a commercially reasonable manner," or transfer those assets to one or more separate affiliates at their book value, in which case no stranded cost recovery is allowed. In Arizona, utilities are given the option to divest generation by means of an auction, or they may retain ownership, but will only be allowed sufficient revenues to maintain financial integrity.

However, it is not always necessary to divest an asset in order to determine its fair market valuation. In some cases (e.g., nuclear plants), it may be more feasible to sell a contract for the output of the generating unit. Appraisal by independent, third-party appraisers is another option. While a few states allow for the appraisal of the assets to estimate their market values (e.g., California), states tend to favor divestiture because of other benefits. First, any sales premium in excess of book value can be immediately applied to "netting," i.e., to offset other stranded costs. With netting, the above-market value of a utility's "stranded" assets is offset by the sales premium of assets with book values below their market value.² For example, the netting efforts of a utility in Massachusetts has enabled a 43% reduction in its stranded cost charge (in addition to a 15% rate reduction). Second, states believe that divestiture is an effective form of market power mitigation. They argue that separating generation from transmission eliminates the potential for self-dealing between regulated and unregulated business units. A third benefit is

²See Eric Hirst, *Policy Choices for Electric-Utility Stranded Costs*, (Washington, D.C.: The Electricity Consumers Resource Council, July 1998)

that the utility's success in maximizing netting (and other forms of mitigation) is used to determine the degree to which the utility has an opportunity to recover its remaining stranded costs. The Maine law has one of the most explicit, and simple, statutory requirements for encouraging this benefit. The potential netting from generation divestiture has become one of the most frequently adopted options in states where utilities are required to take all reasonable actions to mitigate stranded costs.

MITIGATION OF STRANDED COSTS

Only Michigan does not have a formal policy requiring the mitigation of stranded costs. All other state restructuring laws and rulemakings enacted to date address the issue, and the more recently enacted laws or rulemakings are increasingly more demanding. Generally, a restructuring law requires utilities to pursue "all" or "every" reasonable effort such as maximizing the market values of their assets (and realizing the market value of such assets by bringing the asset to market), decreasing costs, and increasing sales of existing and new services. In Illinois, the restructuring law provides for a schedule of "mitigation factors" which are deducted from a utility's stranded cost charges on a per kilowatt-hour basis. The mitigation factors in the Illinois law begin at a minimum of 0.5 cents per kWh and increase to a minimum of 0.9 cents. The actions necessary to offset these rate reductions are left to the discretion of each utility's management.

The most effective mitigation efforts to date are cost-cutting and the divestiture of generation assets. Even before most states enacted restructuring legislation, utilities were under regulatory and market pressures to cut costs in anticipation of restructuring. Work force reductions were prominent in their cost-cutting programs. But other expenses were also cut such as social programs. For example, between 1992 and 1997, utility spending on demand-side management programs has been cut by 63%, or \$1.5 billion. However, decades of "cost-plus" thinking and operating practices argue for still deeper cuts to bring each utility's overall cost structure in line with unregulated competitive businesses. The popular policy link between stranded cost recovery and stranded cost mitigation has at least temporarily shifted the focus to asset divestiture. By the end of 1998, over twelve percent (approximately 77,500 MW) of the total investor-owned electric utility fossil and hydro generating

MITIGATION OF QUALIFYING STRANDED COSTS

MODEL LEGISLATIVE LANGUAGE

Mitigation—(a) Utilities have had and continue to have an obligation to take all reasonable measures to mitigate stranded costs. Mitigation measures may include, but shall not be limited to:

- (1) Reduction of expenses;
- (2) Renegotiation of existing contracts;
- (3) Refinancing of existing debt;
- (4) Voluntary retirement, sale, or write-off of uneconomic or other assets; and
- (5) Maximization of market revenues from existing rate base generation.

The commission may reduce or increase the amount of stranded costs that the commission allows a utility to recovery based on the efforts of the utility to mitigate its stranded costs.

(b) The energy component of any stranded cost charge recoverable from customers shall be reduced by the mitigation factor which represents the amount attributed to new revenue sources and cost reductions by the utility through the end of the period for which stranded costs are recovered.

(c) Mitigation Factor—The mitigation factor shall be the amount equal to the greater of (1) 0.9 cents per kilowatt-hour, or (2) 12% of base rates in effect on {some date prior to law's enactment} or any contract rate in effect during the year proceeding the date of eligibility for retail access.

These provisions are adapted from the New Hampshire, Connecticut, Illinois, and Maine restructuring laws.

ALLOCATION OF QUALIFYING STRANDED COSTS

MODEL LEGISLATIVE LANGUAGE

Allocation of Stranded Costs—(a) The transition to competitive generation market shall be orderly, protect electric system reliability, be fair to ratepayers and provide the investors of electric utilities with a fair opportunity to fully recover the amount of stranded costs that the commission determines to be just and reasonable.

(b) In making its determinations, the commission shall balance the interests of ratepayers and utilities during and after the transition. Nothing in this section is intended to provide any greater opportunity for stranded cost recovery than is available under applicable regulation or law on the effective date of this act.

(c) The qualifying stranded costs to be recovered shall be allocated to customer classes in a manner that does not shift interclass or intraclass costs and maintains consistency with the allocation methodology for utility production plant accepted by the commission in the electric utility's most-recent base rate proceeding.

(d) **Rate Caps**—For a period of 3 years from the effective date of this act or until the electric utility is no longer recovering its stranded costs, whichever is shorter, the following caps on electric utility rates shall apply:

(1) The total charges of the utility for services to any customer who purchases generation from that utility shall not exceed the total charges that have been approved by the commission for such services as of the effective date of this act; and

(2) For customers who purchase generation from a supplier other than the utility, the charges of the utility for non-generation services that are regulated as of the effective date of this act, exclusive of any stranded cost charge, shall not exceed the non-generation charges that have been approved by the commission for such service as of the effective date of this act.

These provisions are adapted from New Hampshire and Pennsylvania restructuring laws.

capacity is up for sale or sold. Bid prices, on average, are almost double book values. Auctions employing third-party auctioneers have become the most common mechanism for selling off the assets.

ALLOCATION OF STRANDED COSTS

The allocation of stranded costs between utility shareholders and ratepayers, and among the different customer classes is addressed by all restructuring laws and rulemaking proceedings. State laws (or rules) increasingly require a “sharing” of the burden between shareholders and ratepayers.

This sharing principle is justified for several reasons. First, traditional regulation, by design, was supposed to produce “just and reasonable” rates, *i.e.*, balance the interests of shareholders and the utilities’ customers or “ratepayers.” In addition, so-called “prudence” and “used and useful” standards were regulatory tools intended to mirror competitive market conditions. These tools were supposed to prevent utilities from earning profits on assets that are deemed unreasonably excess to actual needs (not “used”) or uneconomic (not “useful”), yet provide utilities with a reasonable opportunity to recover their costs. That same balancing act should continue as these costs are realized during the transition to a restructured industry. A second reason in support of sharing is that such mechanisms can encourage utilities to take all prudent actions to mitigate those costs if part of those costs are at risk. This is another principle of traditional regulation whereby regulation is a surrogate for competition, and should promote the same efficient outcomes as a competitive market. Finally, traditional regulation only provided utility shareholders with a reasonable or fair “opportunity” to the recovery of all prudently incurred costs (plus a fair return on such costs), not an ironclad guarantee. Many state laws or restructuring rules stipulate that utilities are only

entitled to a reasonable or fair opportunity to recover their stranded costs.

The states have created a variety of sharing mechanisms that encourage mitigation. In Arizona, a fixed “sharing percentage would be determined prior to mitigation,” and then as an incentive, utilities are allowed to keep any subsequent mitigation savings. Other states (e.g., California and Montana) restrict the amount of costs recovered from ratepayers by limiting the period of time over which the utility may recover stranded costs. This is typically coupled with a rate cap for maximum effect. The Connecticut law explicitly states that the determination of stranded costs “should be based on the principles of fairness and reasonableness and the result of a balance of the interests of electric customers, electric utilities and the public at large.” In Illinois, the amount of stranded cost recovery from customers is directly related to the number of customers who ultimately leave the utility to shop elsewhere. The greater the number leaving the system, the lower their stranded cost recovery. Pennsylvania law requires that any allocation of stranded generation plant costs between ratepayers and shareholders must be “just and reasonable.”

States generally prohibit stranded cost recovery that results in any cost shifting among customer classes. The typical statutory provision requires the state’s regulatory commission to maintain the status quo. The intent of this approach is to allocate cost responsibility to customers, in the form of a stranded cost charge, to kilowatt-hour (kWh) energy charges and kilowatt (kW) demand charges, in the same manner as under existing tariff or contract rates. Otherwise, costs are unfairly shifted from one customer class or customer to another customer class or customer. For example, the Arizona rules specify that: “[s]trand- ed cost shall be recovered from customer classes in a manner consistent with the specific compa- ny’s current rate treatment of the stranded asset, in order to effect a recovery of stranded cost that is in substantially the same proportion as the

recovery of similar costs from customers or customer classes under current rates.” Pennsylvania law prohibits interclass and intraclass cost shifts, and requires that consistency be maintained with the allocation method used by the commission in each utility’s last rate case. Pennsylvania also enforces this policy by capping rates on a per-customer basis.

A problem in states served by multi-state utility holding companies is the potential for the stranded cost liability to be shifted from one state to another. The potential is greatest when two or more operating companies jointly own a generating unit or purchased power contract. The parent holding company will seek to recover a disproportionate share of the total liability from the state whose stranded cost recovery policy is deemed the more generous from the utility’s perspective.

RECOVERY OF STRANDED COSTS FROM CUSTOMERS

EXCEPTIONS TO QUALIFYING STRANDED COSTS

MODEL LEGISLATIVE LANGUAGE

Normal Course of Business—Stranded cost charges shall not be recoverable for changes in usage occurring in the normal course of business, including those resulting from changes in business cycles, termination of operations, weather, reduced production, changes in manufacturing processes and fuels, installation or expansion of new self-generation or cogeneration equipment, performance of existing self-generation or cogeneration equipment, energy conservation efforts or other similar factors.

This provision is adapted from the California restructuring law.

RECOVERY MECHANISMS FOR QUALIFYING STRANDED COSTS

MODEL LEGISLATIVE LANGUAGE

Recovery Mechanisms—(a) Customer bills shall contain unbundled charges sufficient to determine the basis for those charges, utilizing line itemization to reveal the various component costs of providing electric services. These shall include unbundled prices or rates for generation, transmission, distribution, other services, and any stranded cost charges.

(b) A customer who significantly reduces or eliminates consumption of electricity due to self-generation, conversion to an alternative fuel or demand-side management may not be assessed an exit or reentry fee in any form for the reduction or elimination of consumption or reestablishment of transmission or distribution service.

(c) Each utility shall develop a discounted stranded cost recovery methodology that a customer may choose to determine an amount in lieu of making monthly payments.

(d) Utilities may file with the commission tariffs for electric service rates that foster economic development or retention of existing customers within the state. Stranded cost charges are the only charges that are imposed upon a customer class to recover transition costs under this section. A separate exit fee may not be imposed.

These provisions are adapted from the restructuring laws of Pennsylvania, Oklahoma, Montana, and Maine, and the restructuring order of the Arizona Corporation Commission.

Once net qualifying stranded costs that are recoverable from customers are determined, one or more mechanisms for assessing those costs on the utility's ratepayers must be developed. While some state legislatures deferred this issue to their respective state regulatory commission, most restructuring laws prescribe a specific approach or placed restrictions on the method used. State restructuring laws also often set conditions on the recovery mechanism to avoid any increase in existing rates charged to customers, or for other purposes.

A separate unbundled charge on the customer's bill is a common collection method. California adopted this approach first, with a euphemism, the "competitive transition charge" or "CTC." Several other states have since labeled their charge a CTC. In other states it is deemed a "wires" charge—an assessment on transmission and distribution service charges. These charges take the form of an adder or surcharge on a kilowatt-hour or kilowatt (or both) basis. An option that some of the more recently enacted restructuring laws or rulemakings offer is the ability of an individual customer to negotiate the terms of payment. For example, in Arizona, utilities are required to offer a discounted stranded cost recovery method. This would allow a customer to make a single, discounted, lump sum payment to settle its stranded cost liability with the utility.

A common limitation in state restructuring laws on the imposition of a stranded cost recovery charge is a requirement that rates also be capped or frozen. Rate caps are better than rate freezes because the former allows for rate reductions resulting from improvements in service. Typically, rates are capped or frozen as of the date of the law's enactment or some other time prior to enactment. This provision serves several purposes. First, it prevents utilities from recovering stranded costs in excess of what already are recovered in rates. Second, it prevents cost shifting, particularly if rates are capped on a per-customer basis. Third, it creates a powerful incentive for further cost cutting.

SECURITIZATION

A couple of states, notably California and Illinois, allow the “securitization” of part of the utilities’ stranded costs to fund an immediate rate reduction. Other states also allow securitization as a stranded cost recovery mechanism. Pennsylvania, Montana, Illinois, Massachusetts, Rhode Island, and Connecticut allow this option. Several of these states have limited the applicability of securitization to stranded costs that are not associated with generation assets, or allow securitization to be used for only a portion of a utility’s total stranded cost liabilities. States are also increasingly requiring that the proceeds from securitization be used to directly offset stranded costs. In Maine, legislation authorizing securitization was tabled because utility mitigation efforts by other means deemed it unnecessary.

Securitization refers to the creation of a financial security or bond that is backed by a revenue stream pledged to pay the principal and interest of that security. In California, the securities are called “rate reduction bonds” or RRBs. In Illinois, the bonds are called “transitional funding instruments.” Securitization generally requires legislation to establish the creation of a transferrable property right (or “intangible transition property”) to collect from the utility’s ratepayers an irrevocable customer charge which is used to recover principal, interest, insurance, and other costs. In California, the charge on customer bills is called a “trust transfer amount” (TTA). In Illinois, it is called the “instrument funding charge.” Since ratepayers, and not the utility, are irrevocably obligated to pay off the debt, these securities should, in theory, command a lower interest rate than utility bonds. This reduced interest rate constitutes the potential savings to ratepayers of securitization. Recent evidence suggests that these potential savings are quite small because utilities have already refinanced their high-cost debt to take advantage of existing lower interest rates. Issuance and other fees associated with securitization also offset much of the potential savings.³ Other savings may accrue if the bonds are tax exempt. Some analysts

THE SECURITIZATION OF QUALIFYING STRANDED COSTS

MODEL LEGISLATIVE LANGUAGE

Securitization—(a) The commission shall consider the effect on all customer rates and other factors relevant to reducing rates in determining the amount of securitization and the manner in which and the period over which it shall be imposed in any decision of the commission. Any exemption from the costs of securitization by customers under a special contract shall not result in an increase in rates to any customer.

(b) The aggregate principal amount to be securitized shall not exceed 25% of the applicable electric utility’s total capitalization.

(c) Stranded generation assets may not be securitized. No non-generation-related stranded costs shall be funded with the proceeds of securitization unless the utility proves to the satisfaction of the commission that the savings attributable to such funding will be directly passed on to customers through lower charges, and the commission determines such funding will not result in giving the utility or any of its affiliates an unfair competitive advantage.

(d) Proceeds—The proceeds from the assignment, sale or transfer or other financing of intangible transition property shall be used principally to reduce the electric utility’s stranded costs and to reduce the related capitalization. Such proceeds shall not be applied to purchase new assets, or to pay dividends to shareholders or operating expenses other than taxes resulting from the receipt of such proceeds.

(d) Customer charges necessary to payoff securitization bonds shall be applied and invoiced to each retail customer or class of retail customers obligated to pay base rates, other stranded cost charges, or other rates for tariffed services.

These provisions are adapted from the restructuring laws of Connecticut, Illinois and Pennsylvania.

³The California consumer groups that supported the referendum cite an actual customer bill in which the 10% rate reduction (\$24.57) was more than offset by the “trust transfer amount” (\$35.20).

argue that this is the only source of savings. However, many ratepayers may “see” a lower charge on their bill only because the amortization period for the new bonds is longer—the payment period has been stretched out, and hence, the lower monthly payment. Ratepayers save nothing on a cumulative basis, and out-of-pocket costs are greater.

Securitization also shifts significant risk to consumers because of the need to forecast future market conditions when initially setting the amount of the principal to be securitized. This amount is irrevocable, and if the actual amount of costs stranded due to competition is less than the forecasted amount, consumers are liable for the overpayment. This problem can be partially solved by limiting the amount of stranded costs that are securitized and authorizing the state regulatory commission to adjust the recovery of the unsecuritized amount from customers to true-up total charges based on actual costs.

Despite these limitations, securitization has a role in the overall stranded cost recovery process. After a utility has successfully mitigated its stranded costs, and the state’s regulatory commission determines a fair sharing of the final stranded cost obligations, some portion of the amount recoverable from customers may be securitized if a material benefit can be established. Qualifying stranded costs other than generation or other tangible assets may be best suited for such treatment.⁴ When this option is used, the utility must be required to use the cash to retire existing debt, redeem bonds or buy back stock.

CONCLUSIONS

States are rapidly mandating the restructuring of the electric utility industry by deregulating generation and other potentially competitive services, and providing for retail-level competition that will enable all consumers the option to choose their suppliers of these services. Notwithstanding the political backlash in California and Massachusetts over stranded cost recovery, most other states have struck a more acceptable balance between the interests of utility shareholders and utility customers over the disposition of these costs.

Traditional regulation intended to be a surrogate for a competitive marketplace. Regulatory standards and practices were supposed to produce efficient planning and operation of the electrical system, while balancing the interests of the utility and its ratepayers. Yet, stranded costs are the unfortunate legacy of the failure of the regulatory process to produce those results. The transition to competitive markets in this industry should be used as an opportunity to restore that balance. States that have yet to join this restructuring initiative are urged to follow the example of the first states where the transition is working. ■

APPENDIX

STATE LAWS MANDATING ELECTRIC INDUSTRY RESTRUCTURING

⁴Generation assets can be refinanced by traditional means because the asset itself can be used as collateral.

State	Date of Enactment, and/or Citation, and Website for Downloading Statutory Language
Arizona	<p style="text-align: center;"><i>H.B. 2663, 5/29/98</i> www.azleg.state.az.us/legtext/43leg/2r/bills/h651-700.htm <i>Arizona Corporation Commission's Restructuring Decision:</i> www.cc.state.az.us/utility/electric/decision.htm</p>
California	<p style="text-align: center;"><i>A.B. 1890, 9/23/96</i> www.cpuc.ca.gov/electric_restructuring/er_home_page.htm</p>
Connecticut	<p style="text-align: center;"><i>H.B. 5005, 4/29/98, Codified as Public Act N° 98-28</i> www.cga.state.ct.us/ps98/act/pa/pa-0028.htm</p>
Illinois	<p style="text-align: center;"><i>H.B. 362, 12/16/97</i> <i>(codified as 220 ILCS 5/16-101 new)</i> http://icc.state.il.us/icc/Doclib/Ref</p>
Maine	<p style="text-align: center;"><i>P.L. 1997, c. 316, 5/29/97</i> <i>(codified at 35-A MRSA §3(new))</i> www.state.me.us/mpuc/er-page.htm</p>
Massachusetts	<p style="text-align: center;"><i>H.B. 5117, 11/25/97</i> <i>Chapter 164 ("Acts of 1997")</i> www.magnet.state.ma.us/dpu/restructuring.htm</p>
Montana	<p style="text-align: center;"><i>S.B. 390, 5/2/97</i> www.psc.mt.gov/gaselec/elec.htm</p>
Nevada	<p style="text-align: center;"><i>A.B. 366, 7/16/97</i> <i>(NRS §704.965 to §704.990)</i> www.leg.state.nv.us/NRS/CH_704.htm</p>
New Hampshire	<p style="text-align: center;"><i>H.B. 1392, RSA 374-F, 5/22/96</i> www.puc.state.nh.us/d96150pg.htm</p>
Oklahoma	<p style="text-align: center;"><i>S.B. 500, 4/25/97; S.B. 888, 6/12/98</i> <i>(codified at Title 17, OS, §190.1, et seq.)</i> www.occ.state.ok.us/TEXT_FILES/Electres.htm</p>
Pennsylvania	<p style="text-align: center;"><i>P.L. 802, No. 138, 12/3/96</i> <i>(codified at 66 Pa. C.S. §§2801 et seq.)</i> http://puc.paonline.com/acts1509.htm</p>
Rhode Island	<p style="text-align: center;"><i>H-8124 Substitute B3, 9/7/96</i> <i>(R.I.G.L. §39-1+2)</i> http://ripuc.org/electric/96h8124b.htm</p>

NOTE: The model legislative language recommended in this paper is adapted from the restructuring laws of nine states, except for Arizona. Most of the language is verbatim as codified in the respective law. Changes, deletions, or additions were made to enable uniform terminology and editorial style, for clarification purposes, or to reconcile differences between states. Some language was abbreviated or paraphrased to fit space limitations. In all cases, every effort was made to preserve the legislative intent of each provision in its original form and context as understood from a plain-English reading of the applicable law.

SOURCES: The information and data contained in this paper are taken from a variety of sources, particularly the Websites of state legislatures and public utility commissions. These sites are noted in the Appendix. The paper also used the results of an ELCON-sponsored survey of attorneys who represent industrial consumer groups in the states that are implementing retail access (See "Survey Results," Survey of State Actions on Electric Industry Restructuring and Stranded Cost Recovery, The Electricity Consumers Resource Council, October 1998). Additional information was taken from two periodicals published by the Edison Electric Institute: *Retail Wheeling & Restructuring Report* and *Divestiture Actiton & Analysis*, and McGraw-Hill's energy news services. Other sources are referenced in footnotes.

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