



The Nuclear Industry's Open Bar Tab at the State Regulators Saloon

There is no such thing as a natural monopoly: government creates all monopolies. There was never any real justification for the regulation of the electric utility business. The existence of utility regulation is a triumph of political entrepreneurship by the incumbent utility companies to use the power of state government to gain dominance over their customers, to eliminate their more efficient competitors and to obtain recovery on their bad investments. Those ends remain the goal of regulation today.

In the earlier free-market era of the electricity industry there were quickly developing large efficiency improvements in the generating technology. Incumbent utilities were constantly being underpriced by newer competitors with cheaper generation. The existing utilities wanted guaranteed recovery on their obsolete assets. They turned to political means. The monopoly-regulatory system still serves that same purpose.

The system of politicized energy distribution consumes more resources than necessary to provide service. The excess revenues flowing into the system have provided profits above what could be obtained in a competitive market. The money has been further dissipated by inefficient operations, provided recovery on unproductive and inflated investments, been shifted to unregulated affiliates, passed through to satisfy uneconomic fuel contracts and consumed in efforts to preserve monopoly status rather than to satisfy consumer demand.

The monopoly-regulatory regime has created politically focused but ineffective management, weakened the work ethic, created accounting systems that do not report costs properly and obscured market feedback from consumers. Sheltered from market forces, utilities operate to satisfy political whims. The practice of cross-subsidy has distorted management information, and consequently, management behavior. Cost-plus, rate-of-return regulation has corrupted operating practices as well as investment standards. Utility regulation is an unholy union of vested economic privilege and authoritarian ideology that spawns the Rosemary's baby of cronyism.

It is now standard practice in the electric utility industry to create a holding company for the regulated utility and to own several unregulated companies. Utility affiliates that prosper do so by shifting costs to regulated sister companies; those affiliates that get into truly competitive situations fail. Lucrative projects are done under the unregulated affiliates, and risky projects are done under the regulated company. When we see nuclear plants, efficiency programs and green energy development being done under the regulated company, we know these are financial turkeys. If they had merit they would be done under the unregulated business units.

A goal of contracting in the normal business world is to put risk on the parties best able to handle that particular risk. In a large construction project under market conditions the lenders will enter into interest swaps to mitigate the risk of higher interest rates during the construction phase of capital projects. General contractors require the sub-contractors to have bonds to stabilize their risks; the fuel suppliers will take out futures contracts to remove changes in price risk. All that goes away when a nuclear plant is built under regulation. The risk is placed on the party least able to handle risk – namely the utility customers.

When a nuclear project has a \$2 billion cost overrun, champagne corks pop on Wall Street, and the CEO of the utility is hailed within the industry as a visionary leader.

No nuclear plant has ever been built under market conditions. There have been about 500 nuclear plants built worldwide and maybe another hundred in some stage of planning. All are either owned outright by governments or receive special treatment from government. It appears nuclear plants cannot pass the market test.

Using the nuclear Vogtle plant in Georgia, as an example, we see a government-granted cap on liability, production tax credits, a federal loan guarantee and pre-collection of profits. This makes Georgia Power the nation's biggest welfare queen.

Georgia's Vogtle project was born in deception and continues to employ phony rationalizations, misleading numbers and outright prevarication in regulatory proceedings and public statements

As a condition of starting the project Georgia Power demanded and received permission to collect financing cost of assets in place as the project was being built. This is called CWIP - Construction Work In Progress. The utility also obtained the right to collect on any expenditures, plus profit, if the project were abandoned.

Financing costs for a utility are not just the interest on loans but the return based on its capital structure. Most utility capital structures have about 50% debt and 50% equity. So if the cost of debt is 4% and equity returns are 12%, the blended rate of return is 8%. CWIP provides that, in our example, about one-fourth of the funds are collected as interest on debt and the other three-fourth as profits for shareholders. Right now the projected collections under CWIP for Vogtle are well over \$1 billion with most of that in profits before the plant is built!

When this was pointed out during the debates in the Georgia General Assembly, Georgia Power's financial spokesman explained that this money was not profits but merely the cost necessary to attract capital. This same person appeared as a witness in the regulatory proceedings before the GA Public Service Commission and was asked if Georgia Power were a non-profit entity.

At the time Georgia Power sought approval for this project, the cost number they used was \$14 billion. This seemed strange at the time because many other utilities were considering similar projects with estimates of \$17 to \$18 billion. This was cleared up when, in June 2009 shortly after the GA PSC approved the project, a GA Commissioner appeared before a gathering of Southeastern utility regulators in Charleston, SC and said he did not expect the \$14 billion number to be the final number. There you have it. A low number was used to justify the project with extra costs being revealed after a lot of sunk cost has been made – now running about \$18 billion. Recently the GA PSC staff has pointed out that with the now-known current schedule and cost, the project might not have been approved. Georgia Power reluctantly has agreed.

There has been more use of spin in the periodically reporting of the construction progress than any other case in recent memory at the GA PSC. Georgia Power had said that CWIP saves customers \$300 million in avoided interest costs by paying financing cost as you go. But this number was an absolute number not a present value number. The GA PSC staff ran the present value of the alleged savings and found the present value was negative. Yet the number is still being bandied about by the Company and the Commissioners.

A Georgia Power witness was asked if sales tax had that been taken into account when computing these "savings." She remarked that customers would have to pay the sales tax anyway whenever the cost was recovered. Oh yeah. Well a family paying visa bill charges right now might prefer to pay the sales tax during the 60-year life of the plant starting probably in 2020. This raises an issue unique in regulatory vocabulary about "generational equity." Should current electricity customers pay for facilities to be used by future generations?

A former governor has taken GA Power to court claiming that state law forbids charging sales tax on financing costs. GA Power, who publically claims they do everything they can to hold down customer costs, is fighting this case claiming that the money goes to governments – as if that were a good thing.

Every six months GA Power makes an analysis to compare the cost to complete the project verses an alternative. This compares a half-built nuclear plant to a from-the-start gas-fired combined cycle plant. GA Power then says they are saving customers billions of dollars. Very misleading. Utilities all over the country are cancelling and deferring nuclear projects because they say the economics do not justify the huge and uncertain first costs.

With the collapse of the Berlin wall and turn toward capitalism in China, the last defenders of command-and-control economics are North Korea, Cuba and US state level utility regulators.

And finally, here is the nuclear utility's version of the 23rd Psalm:

Regulation is my Shepard, I shall not want

Thy maketh me to lie about green programs; Thy leadedth me beside stilled public opinion

Thy restoreth my territorial protections; Thy leadedth me down the paths of monopoly for its name's sake

Yea, though I walk through the valley of the shadow of nuclear debt, I fear no evil cost overruns; for thou art with me; Thy guaranteed pass-thrus and Thy pre-payments, they comfort me

Thou riggest a bid before me in the presence of my potential competitors; thou anoinest my balance sheet with inflated assets; my earnings runneth over

Surely profits and corruption shall follow me all the days of my life, and I shall dwell in the house of regulation forever.

Jim Clarkson

www.rsmenergy.com