

STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

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Joint Petition of Niagara Mohawk Power
Corporation, New York State Electric & :
Gas Corporation, Rochester Gas and
Electric Corporation, Constellation :
Nuclear, LLC and Nine Mile Point Case No. 01-E-0011
Nuclear Station, LLC for Authority :
Under Public Service Law Section 70 to
Transfer Certain Generating and Related :
Assets and for Related Approvals.
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**COMMENTS
OF**

**ELIOT SPITZER
ATTORNEY GENERAL
OF THE
STATE OF NEW YORK**

**REGARDING
SETTLEMENT PROPOSALS**

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INTRODUCTION

Section 70 of the New York State Public Service Law (“PSL”) requires that, before regulated investor-owned New York utilities may sell significant capital assets, the New York State Public Service Commission (“Commission” or “PSC”) must determine that such sale would be in the public interest. On January 31, 2001, four New York utilities filed a Joint Petition with the Commission requesting authority to transfer their interests in the Nine Mile Point One (“Nine Mile One”) and Two (“Nine Mile Two”) nuclear electricity generating plants, located near Oswego, to Constellation Nuclear, LLC (“Constellation Nuclear”) and Nine Mile Point Nuclear Station LLC (“Nine Mile Point NS”). Constellation Nuclear and Nine Mile Point NS are wholly owned power-generating subsidiaries of Constellation Energy Group, Inc. The Niagara Mohawk Power Corporation (“Niagara Mohawk”) owns all of Nine Mile One and has a 41% interest in Nine Mile Two. The three other utilities own interests in Nine Mile Two: Rochester Gas & Electric Corporation (“RG&E”)(14%); the New York State Electric and Gas Corporation (“NYSEG”)(18%); and the Central Hudson Gas & Electric Corporation (“Central Hudson”)(9%).¹

The Commission instituted Case No. 01-E-0011 to review the Joint Petition, and designated Administrative Law Judge (“ALJ”) William Bouteiller to preside over that proceeding. Eliot Spitzer, Attorney General of the State of New York, has been a party to the proceeding since its inception. The Office of the Attorney General has participated in all phases of the proceeding, attending pre-hearing conferences, submitting statements and participating in settlement negotiations.

¹ The Long Island Power Authority owns the remaining 18% interest in Nine Mile Two and is keeping all of that interest.

Four settlement proposals have been filed with the Commission regarding, *inter alia*, the sale of the Nine Mile Point plants, the disposition of the sales proceeds and the treatment of utility losses on the sales. On May 11, 2001, Niagara Mohawk, the Staff of the New York State Department of Public Service (“DPS”) and Multiple Intervenors (“MI”) filed a Joint Proposal for approval of the transfer of all of Niagara Mohawk’s interests in Nine Mile One and its 41% interest in Nine Mile Two (“Niagara Mohawk Joint Proposal”).² On August 9, 2001, RG&E and the DPS Staff filed a Joint Proposal for approval of the transfer of RG&E’s 14% interest in Nine Mile Two (“RG&E Joint Proposal”).³ On September 19, 2001, Central Hudson and the DPS Staff filed a Joint Proposal for approval of Central Hudson’s 9% interest in Nine Mile Two (“Central Hudson Joint Proposal”).⁴ On September 20, 2001, Constellation Nuclear, Nine Mile Point NS and the DPS Staff filed a Joint Proposal intended to settle various issues concerning operation of the plants after transfer of ownership (“Constellation Joint Proposal”).⁵ No proposed settlement has been filed concerning NYSEG’s 18% interest in this proceeding.

² Joint Proposal To New York State Public Service Commission Among Niagara Mohawk Power Corporation, New York State Department Of Public Service Staff, and Multiple Intervenors on Behalf of its Members in the Niagara Mohawk Service Territory, May 7, 2001.

³ Joint Proposal To New York State Public Service Commission between Rochester Gas and Electric Corporation and New York State Department Of Public Service Staff, August 7, 2001.

⁴ Joint Proposal To New York State Public Service Commission between Central Hudson Gas & Electric Corporation and New York State Department Of Public Service Staff, September 19, 2001.

⁵ Joint Proposal To New York State Public Service Commission Between Constellation Nuclear, LLC and Nine Mile Point Nuclear Station, LLC and New York State Department Of Public Service Staff, September 19, 2001.

On September 18, 2001, the Commission issued a “Notice Inviting Comments” (“Notice”) regarding the Niagara Mohawk, RG&E and Central Hudson Joint Proposals. The Notice does not refer to the Constellation Joint Proposal. We therefore do not address that Proposal here. Under the Notice, the date by which parties may file comments regarding the Niagara Mohawk, RG&E and Central Hudson Joint Proposals is September 25, 2001.

These are the Attorney General’s comments regarding the Niagara Mohawk, RG&E and Central Hudson Joint Proposals.

ARGUMENT

I

The Settling Utilities, Not Their Customers, Should Absorb All Stranded Costs.

Niagara Mohawk, RG&E and Central Hudson each propose to sell their respective interests in the Nine Mile Point power plants (“Nine Mile”) for less than the cost of their interests. The difference between the sale price and the cost of each utility’s interest is a loss, commonly referred to in utility regulation as a “stranded cost.” Together, the three utilities’ stranded costs from the sale of Nine Mile will exceed a billion dollars. At issue here is who should bear these stranded costs, the utilities’ customers or their shareholders. The position of this Office has been and remains that utility shareholders, in return for the possibility of reward, assume the business risk of loss. The Joint Proposals do not require the utilities, and thus their shareholders, to bear the full stranded costs and therefore should be rejected.

Stranded costs occur when utilities make uneconomic investments in assets, such as power plants, and then dispose of those assets at a loss. As long as a utility keeps an asset, the fact that it is uneconomic is disguised. This is due to how utilities are regulated. When the Commission

sets a utility's electric rates, a portion of the rates compensates the utility for the cost of building or buying assets such as power plants and another portion compensates utility shareholders for the use of their funds invested in the assets. Under normal utility regulation practice, utilities pay for building power plants and then recover those construction costs in rates after the plants enter commercial service. Utilities finance power plant construction by borrowing and by using shareholder investments.

Power plants are very expensive and normally last for many years. Consequently, customers pay for a plant in monthly installments over many years. The time period set for the recovery of a plant's cost is intended to approximate the useful life of the plant. As customers pay for a utility plant, they reduce the cost of the plant to the utility. This is reflected in the utility's accounting as the plant's "book value." The book value of a plant should equal the utility's remaining cost of building the plant and approximate its current value for producing electricity.

In this proceeding, the four regulated utilities owning interests in Nine Mile auctioned off those interests for a sale price lower than each utility's remaining book value reflecting the cost of building the plants. Thus, the market has determined that the Nine Mile plants cost more to build than they are currently worth.

Comparison of the respective proposed sales prices with Niagara Mohawk's and RG&E's respective book values for their interests in the Nine Mile plants reveals that the sales prices are significantly lower than the amount of Nine Mile costs on the utilities' books. Niagara Mohawk indicated in May 2001 that it had \$1.277 billion in Nine Mile One and Two costs on its books, and that after applying the proceeds from the sale of its interests and absorbing \$123 million of the

loss as here, it would have \$686 million in stranded costs.⁶

RG&E owns none of Nine Mile One and a smaller interest in Nine Mile Two than Niagara Mohawk,⁷ and thus has a lower Nine Mile cost on its books. RG&E estimated that if it sold its interest on July 1, 2001, the utility would be unable to recover \$329 million of its Nine Mile Two costs.⁸ RG&E here proposes to absorb \$20 million of its stranded costs.⁹ RG&E would thus still have significant stranded costs remaining after the sale.

The quantification of Central Hudson's stranded cost is different. Central Hudson owns an interest only in Nine Mile Two and asserts that it has no Nine Mile costs today.¹⁰ Central Hudson sold other, non-nuclear power plants at a profit and applied those profits to offset all its Nine Mile Two costs, some \$291 million.¹¹ Ordinarily, utility customers have a claim on the majority of any profits from the sale of utility assets that customers have paid for in rates.¹² Thus, Central Hudson used customer funds to pay off its Nine Mile Two costs, rather than return the money to customers.

⁶ Niagara Mohawk Joint Proposal, Attachment 2.

⁷ RG&E owns 14% of Nine Mile Two. Niagara Mohawk owns all of Nine Mile One and 41% of Nine Mile Two.

⁸ RG&E Joint Proposal, p. 3.

⁹ *Ibid.*

¹⁰ Central Hudson Joint Proposal, *passim*.

¹¹ PSC Case Nos. 00 - E - 1273 & 00 - G - 1274, *initial Brief on Behalf of Central Hudson*, February 15, 2001, at 8.

¹² *See, e.g.*, PSC Case Nos. 00 - M - 0095, 96 - E - 0897, 99 - E - 1020, 00 - E - 1208, & 00 - E - 1461, *Order and Opinion Adopting Terms of Settlement, Subject To Modifications* (issued and effective November 30, 2000), *Settlement Agreement*, at 13 - 14.

In this proceeding Central Hudson proposes to put its net Nine Mile sale proceeds (which it estimates as approximately \$36 million¹³) in a “Benefit Fund” for its customers and to contribute an additional \$19 million to that Fund.¹⁴ Since the amounts that Central Hudson proposes to credit to its customers are considerably less than the \$291 million in Nine Mile Two costs the utility paid itself from funds properly due to customers, it is clear that Central Hudson proposes to sell its interest in Nine Mile Two at a significant loss. What is not made clear in Central Hudson’s Joint Proposal is how the tax consequences and other accounting considerations of Central Hudson’s actions would affect the utility’s remaining stranded cost.

In sum, Niagara Mohawk, RG&E and Central Hudson propose to sell their interests in Nine Mile for over a billion dollars less than those interests cost the utilities, but propose to absorb only about \$162 million of those losses.

The utilities are asking their customers to pay the bulk of their stranded costs. The proposed stranded cost bailout mechanisms vary by utility settlement. Niagara Mohawk and RG&E are asking the Commission to create "regulatory assets" for them equal to the stranded costs that they have not proposed to absorb. These "regulatory assets" would then be included in the utilities’s books as claims against customers and would thus be used in the setting Niagara Mohawk’s and RG&E’s rates.

Central Hudson is not asking for a regulatory asset. Instead, it wants the Commission to confirm that the utility may retire its Nine Mile Two costs by keeping the profits from the sale of

¹³ Central Hudson, January 31, 2001 Affidavit of Arthur R. Upright (“Upright Affidavit”), pp. 12 - 14

¹⁴ *Id.*, p. 4.

other power plants instead of returning those profits to customers.¹⁵

In addition to the stranded costs they are asking their customers to pay, Niagara Mohawk and RG&E are asking for a return, *i.e.*, a profit, on their “regulatory assets.” Niagara Mohawk is asking for 11.8% until the Commission resets its rates¹⁶ and a return equal to its return on transmission and distribution assets thereafter.¹⁷ RG&E is asking for 11.5% until its rates are reset¹⁸ and its overall return thereafter.¹⁹

The bottom line on the Joint Proposals is that the utilities are asking their customers to pick up the bill for a billion dollar loss, and two of the utilities, Niagara Mohawk and RG&E, want to make a profit on their losses.

Customers should not have to pay Nine Mile stranded costs. Customers did not chose to make an uneconomic investment in these plants. Shareholders, on the other hand, voluntarily purchased the selling utilities’ stock. When doing so, they assumed the risk that not all of management’s decisions would be correct.

The very fact that the plants’ market value as determined through a competitive auction is less than the utilities’ cost conclusively proves that the utilities spent more for the plants than they are worth. The utilities’ shareholders should bear the burden of that fact.

15 Cite

16 Niagara Mohawk Joint Proposal, p. 4.

17 *Id.*, pp. 4 - 5.

18 RG&E Joint Proposal, p. 4.

19 *Ibid.*

II

The Commission Has The Authority To Relieve Customers Of The Burden Of Paying Stranded Costs.

In setting rates the Commission must reach a result that is just and reasonable.²⁰ In reaching such a result, the Commission has the authority to direct utilities to absorb stranded costs. Utilities argued that the Commission is legally obligated to require the recovery of all stranded costs from customers. The Commission rejected this proposition in Opinion No. 96-12, issued on May 20, 1996.²¹ After taking note of the utilities' argument, the Commission cited judicial authority for the contrary conclusion, namely, that the public is not required to pay excessive rates in order to provide a company a return on stranded investment. The Commission found as a matter of law that it has considerable leeway to set rates that balance ratepayer and shareholder interests. Finally, the Commission concluded that the sharing of stranded costs will ultimately depend upon the particular circumstances of each utility.²²

The utilities appealed the Commission's conclusion that it is not obligated to direct customers to pay utility stranded costs. *See, Energy Ass'n v. PSC*, 169 M.2d 924 (Sup.Ct. Albany Co.,1966) ("*Energy Ass'n*"). The court upheld the Commission's authority to protect utility customers from stranded costs, stating that the rate setting process does not "insure values or...restore values that have been lost by the operation of economic forces."²³ What matters is

²⁰ PSL § 65(1).

²¹ PSC Case Nos. 94 - E - 0952 *et al.* (issued and effective May 20, 1996).

²² Opinion No. 96-12 at 49-51.

²³ *Energy Ass'n* at 939, citing *Market St. Ry. Co. v Comm'n*, 324 US 548, 546 (1945).

that the end result of the Commission's determination be a "just and reasonable balancing of consumer and investor interests...."²⁴

As to Central Hudson's claim that it has no Nine Mile costs that may become stranded, the ALJ presiding in the current Central Hudson rate proceeding (PSC Case Nos. 00-E-1273 and 00-G-1274) has determined, consistent with the holding in *Energy Ass'n*, that the Commission may relieve customers of that utility's Nine Mile stranded costs. An issue being litigated in the Central Hudson rate case is whether the balancing of interests should take into account the above-market costs paid by Central Hudson's customers for Nine Mile Two's output. In a Procedural Ruling issued March 19, 2001, the ALJ opined that as part of that balancing the Commission may consider disallowing Nine Mile Two construction costs previously recognized for rate making purposes as prudent.

According to the ALJ, the issue is not prudence. Instead, the issue is the Commission's duty to ensure fair treatment of both customers and investors. The ALJ found that:

in adopting the company's [current] rate plan, the Commission introduced a new element of conditionality such that the recovery of Central Hudson's prudent NMP2 costs would be subject to future review (in this case, for example) if they were "strandable."²⁵

The Commission may relieve customers of Nine Mile stranded costs. The Commission, in striking a just and reasonable balance of interests, should exercise its authority and should allocate to Niagara Mohawk, RG&E and Central Hudson, rather than their customers, each utility's

²⁴ *Id.* at 941, *citing, Abrams v. PSC*, 67 NY2d at 214-215.

²⁵ Procedural Ruling at 3-4; emphasis in original.

respective loss from the sale of its Nine Mile assets.²⁶

III

There Should Be No Restriction On The Right To Challenge Utility Profits.

Niagara Mohawk and RG&E in their Joint Proposals ask that the Commission restrict the rights of parties to challenge the profits the utilities earn on regulatory assets. In effect, the utilities want to guarantee their profits on stranded costs. RG&E's request is limited to prohibiting the DPS staff from advocating a return on its regulatory asset different from the company's overall return on its electric operations.²⁷ Niagara Mohawk seeks more. It wants a prohibition against anyone's submitting in a future rate proceeding any evidence or argument that challenges Niagara Mohawk's earning the same return on its Nine Mile regulatory asset as the utility earns on its regular operations.

The Commission should reject both of these proposed restrictions on advocacy in Commission proceedings. Even if voluntary, as is the DPS Staff's agreement to the restriction, such restrictions are against public policy, if not the Public Service Law. The Commission can best carry out its duties if it has before it any evidence or argument pertinent to an issue. Moreover, even if the Commission condones the voluntary renunciation of an advocacy right, it should not impose that restriction on individuals and entities who are not parties to the Joint Proposals containing those renunciations.

²⁶ In doing so, the Commission should, of course, take into account each utility's ability to absorb its loss without imposing an equal or greater cost on its customers.

²⁶ RG&E Joint Proposal, p. 4.

IV

The Disposition Of Nine Mile Power Costs Should Be Decided In Rate Cases.

The Niagara Mohawk, RG&E and Central Hudson Joint Proposals provide for a monthly true-up of the price paid to Constellation by the former owners pursuant to their Power Purchase Agreements with Constellation compared with the actual market cost of power.²⁸ The Joint Proposals further provide that the results of this true-up would be passed along to each utility's customers and reflected as an adjustment in their rates. This issue is better addressed in the utilities' rate proceedings, where all of the factors related to reaching just and reasonable rates can be considered together. The Commission should therefore reject this request. In any event, this Office reserves the right to address these proposed true-up mechanisms in each utility's rate proceedings.

²⁸ Niagara Mohawk Joint Proposal at 8-9; RG&E Joint Proposal at 7; Central Hudson Joint Proposal at 8.)

CONCLUSION

For all the reasons stated herein, the Commission should reject the Joint Proposals.

Respectfully submitted,

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