RECENT FERC ORDERS

CONCERNING

STRANDED INVESTMENT RECOVERY

IN THE ELECTRIC UTILITY INDUSTRY

(Version: 1/7/94)
Entergy Services

(Orders issued March 26, 1992; August 7, 1992; and April 5, 1993)

Entergy Services, Inc. submitted for filing on August 2, 1991 a Transmission Service Tariff which provided for "open access" to Entergy’s transmission system subject to the Tariff’s provisions. The Tariff required that the Entergy companies be reimbursed for the cost of any production, transmission, or distribution facilities that is unrecovered by the Entergy companies as a result of providing service under the tariffs. Entergy argued that the provision was justified and necessary to protect it and its native load customers who would have to bear a larger share of production-related costs if existing power customers leave the system and obtain power elsewhere.

Intervenors objected that Entergy could use this provision to deny transmission service by requiring a substantial payment for any stranded investment and then selling power to the entity at market-based rates -- thereby perhaps collecting monopoly rents. Others objected that the provision is vague and unsupported. An alternative proposed by some was the use of reasonable contract cancellation provisions in place of stranded investment charges.

The Commission recognized\(^1\) that stranded investment costs were not unique to the circumstances of the case at hand. Customers can cause the same impact any time they choose to leave the system. For example, Entergy could face stranded investment costs if a wholesale or retail customer (e.g., a large industrial) builds its own generation instead of buying from Entergy. The Commission acknowledged that the existence of an open-access transmission tariff could exacerbate Entergy’s risk of stranded investment far beyond what was contemplated when Entergy negotiated its current power supply contracts. Also, by filing the open access transmission tariff, Entergy provides the opportunity for wholesale market participants in its market area to trade with each other more easily. This opportunity may result, however, in stranded investment as a transition problem. Therefore, the Commission deemed it appropriate to allow Entergy to recover legitimate and verifiable stranded investment costs on a case-by-case basis.

The Commission did not find it appropriate or possible to prescribe specific terms and conditions applicable to every stranded investment claim. Hence, the meaning of "legitimate and verifiable" will be interpreted by the Commission based on the facts of each specific case. In the Commission’s Order on Rehearing (60 FERC ¶61,168; August 7, 1992), some "general guidelines" for recovery of stranded investment costs were offered:

\(^1\) Entergy Services, Inc., 58 FERC ¶61,234 (March 3, 1992).
- Entergy must demonstrate that obligations were incurred on a customer’s behalf based on a reasonable expectation at the time that the customer’s power contract would be renewed.

- The customer’s stranded investment cost liability cannot exceed the contribution it would have made to fixed costs had it remained on Entergy’s system at its existing rate.

- Entergy must attempt to mitigate the customer’s stranded investment obligation when a customer leaves the system.

Entergy’s eligibility for reimbursement of stranded investment costs, however, was bound by the particular circumstances existing at the time of this case. To be reimbursable, costs must relate to contracts entered into or extended prior to August 7, 1992. Any future potential stranded investment problems must be addressed in the termination and notice provisions of future agreements.
MAINE PUBLIC SERVICE COMPANY

(INITAL DECISION ISSUED MARCH 9, 1993)

On September 25, 1991, several wholesale customers of Maine Public Service Company (Maine PSC) filed a complaint with the Commission alleging that Maine PSC's revenues derived from service to these customers were excessive; therefore, reductions in the company's rates were sought. Although this complaint was dismissed, the customers were motivated to undertake a cost study on the basis of Maine PSC's Form 1 data. The Seabrook 1 cost allocation issue figured prominently in the company's costs. Consolidated with the docket from an August 11, 1992 Maine PSC rate increase filing, the case was heard on September 30, 1992. One of the issues in dispute was whether Maine PSC's Seabrook 1 costs should be allocated to the wholesale customers on the basis of historical (1983) demand or current demand.

The Entergy\(^1\) decision was foremost in Maine PSC's argument supporting the use of an historic allocator for stranded investment. The hearing judge found, however, that Maine PSC failed to show why the circumstances of this case are similar to those of Entergy which justified departures from the normal allocation rules. Unlike Entergy, the Maine PSC case did not concern a utility which needed encouragement and protection to convert to an open-access transmission regime, justifying a departure from normal allocation rules. Here, costs were being stranded due to customers' ordinary reductions in service under their supply contracts, rather than the utility's adoption of an open-access transmission tariff that could exacerbate Maine PSC's risk beyond that originally negotiated under the supply contract. Consequently, the special treatment afforded Entergy was not appropriate here. The fact that a major impetus for customers reducing their service may have been Maine PSC's unfortunate investment in a nuclear facility which saddled the system with unproductive costs does not make the case comparable to Entergy. FERC is not attempting to encourage investments in nuclear facilities, as it is conversions to open-access transmission; hence, no special rule for recovery of stranded investment costs would be justified.

Moreover, in Entergy, reimbursement for stranded investment caused by departing customers was limited to cases in which such service reductions had not been taken into account in past power supply contracts. There, the Commission wrote that, "if an existing agreement specifically waives or otherwise constrains Entergy's stranded investment cost recovery, the agreement will continue to be effective."\(^2\) In the Maine PSC case, the parties had negotiated the terms of any prospective reduction in service in a set of 1985 agreements. A 1987 agreement between the parties provided for the "normal rate base treatment" of Seabrook 1.

\(^1\) 58 FERC \$61,234, on reh'g, 60 FERC \$61,168 (1992).

\(^2\) 60 FERC \$61,168 at p. 61,632 (1992).
Thus, it was determined that FERC precedent on stranded investment does not justify a departure from the traditional rules requiring a current allocator in this case.
FLORIDA POWER & LIGHT

(FILING OF MARCH 19, 1993; AMENDED ON JULY 26, 1993; RELATED FILING ON SEPTEMBER 1, 1993)


The tariff provides that, when a wholesale customer’s contract with FP&L precedes the effective date of this tariff, the wheeling customer will reimburse FP&L for all legitimate and verifiable stranded investment costs associated with providing firm transmission service. The level and basis for FP&L’s assessment of any stranded investment costs will be set forth in the service agreement.

This tariff was accepted for filing by the Commission on September 24, 1993; rates were suspended for five months and set for hearing.

On September 1, 1993, amendments to numerous long-term wholesale transmission service agreements were submitted to the Commission for filing. Three of FP&L’s wholesale customers filed motions to intervene, raising the same cost-of-service issues advanced under the tariff proceedings. One intervenor alleges that FP&L’s filing proposes anticompetitive terms contrary to the antitrust conditions agreed to by FP&L before federal courts and the Nuclear Regulatory Commission. Another argues that the filing should be rejected because it violates existing contractual arrangements and alleges that FP&L did not comply with statutory notice and rate review requirements. In addition intervenors complain that numerous provisions of FP&L’s filing are unjust and unreasonable.

The Commission accepted FP&L’s second filing (with modifications) of proposed rates, suspended the rates for five months and set them for hearing. Finally, the dockets corresponding to the two filings were consolidated for the purpose of hearing and decision.

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'The tariff defines stranded investment as "legitimate and verifiable investment in generation, transmission, or distribution facilities where such investment was incurred to provide electric service pursuant to (i) a legal obligation, (ii) an existing contractual obligation, or (iii) where FPL has made investments based on a reasonable expectation at the time that it would continue to serve the Receiving Party and FPL has reason to believe that such investments will not be recovered as a result of providing the requested transmission service."
On October 1, 1992, as amended on March 8, 1993, United Illuminating (UI) submitted for filing a Transmission Service Tariff (TST) which provided for open-access transmission service by UI to wholesale energy purchasers at cost-based rates. One component of the transmission charge proposed by UI was a stranded investment charge, designed to recover UI’s verifiable costs of investment in production, transmission, or distribution facilities that are unrecovered by UI as a result of providing service to a customer under the transmission tariff. UI argued that its recovery of stranded investment costs is necessary to protect against the loss of retail, as well as wholesale, customers where it has made investment decisions with the expectation that it would continue to serve those customers.

Notice of UI’s filings were published in the Federal Register. No comments were filed.

The Commission found a number of UI’s tariff provisions unacceptable, including those relating to stranded investment:

- The customer shall reimburse UI for any unrecovered stranded generation investment costs incurred as a result of service provided under the transmission tariff; and
- UI may recover stranded investment charges only as provided in service agreements accepted for filing by the Commission.

In Entergy, the Commission stated that any future potential stranded investment costs should be addressed in the termination and notice provisions in future wholesale power agreements, and not in the transmission tariff. UI argued that, while it did not have existing wholesale customers, it did have retail customers that could become customers of a municipal utility system if a municipal in UI’s service territory were to create a municipal utility system. UI thus sought protection from stranded investment costs associated with retail loads served by new, legitimate municipal utility systems.

The Commission did not believe that UI’s rationale adequately distinguished its case from Entergy. In Entergy, the Commission had addressed stranded investment occasioned by

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existing wholesale customers converting from bundled generation and transmission service to transmission-only service. Further, in that case, the Commission limited stranded investment claims to a transitional period including only pre-existing contracts negotiated before Entergy voluntarily agreed to allow open access to its transmission system. In the UI case, however, UI seeks to recover in its wholesale transmission rates generation investment costs that were incurred to provide service to retail customers that leave its system. UI thus essentially seeks permanent protection from what may be legitimate retail franchise competition. This was seen as a state issue. Hence, state and local regulatory authorities have jurisdiction over retail franchise matters; these should provide an adequate forum to address such matters. The Commission thus ordered that UI remove the stranded investment provision while noting, however, that if UI were able to demonstrate the lack of a forum for these issues, it would consider revisiting this question.
CINCINNATI GAS & ELECTRIC AND PSI ENERGY

(Order issued August 16, 1993)

On December 23, 1992 (as amended on July 9, 1993), Cincinnati Gas & Electric Company (CG&E) and PSI Energy (collectively, Applicants) tendered for filing a joint application for an order authorizing and approving a proposed corporate reorganization. The proposal is part of a larger reorganization under which CG&E and PSI's parent company, PSI Resources, would merge into a new holding company, CINergy Corporation. As part of their application, the Applicants included a pro forma transmission tariff, which, the Applicants stated, will provide for open access to their transmission systems after the transaction is completed. This tariff contained provisions for recovery of stranded investment as discussed below.¹

Several intervenors protested the proposed transmission tariff's provision for recovery of stranded investment costs, particularly in situations where no construction is needed. Further, intervenors objected that their current interconnection agreement with PSI contains no stranded investment recovery provision, and that the Applicants should be prevented from attempting to impose such costs upon termination of the agreement. Others argued that stranded investment charges should not be assessed in connection with service to "departing" wholesale customers whose wholesale power agreements do not contain a stranded investment recovery provision, once such customers are no longer contractually obligated to CG&E.

In support of their argument that the proposed open access transmission tariff should not be set for hearing, the Applicants committed to revise the tariff such that only "legitimate and verifiable" stranded investment costs in accordance with Commission policy would be recovered. The Applicants also argued that CINergy's public utility subsidiaries will not attempt to recover stranded investment costs from any party in the merger proceeding and, therefore, the issue of whether a charge would be levied on a particular customer is not ripe.

The Commission's Order (64 FERC ¶61,237) of August 16, 1993, held that, unless PSI's or CG&E's existing agreements with its wholesale or transmission customers expressly prohibit the recovery of stranded investment costs, the utilities should be entitled to seek to recover such costs under the transmission tariff. Additionally, the Commission rejected the view that stranded investment costs are not incurred when no new facilities are required to provide transmission service under the tariff, as this argument ignores the fact that PSI and

¹ The transmission tariff defines stranded investment as: legitimate and verifiable investment in generation, transmission or distribution facilities incurred to provide electric service pursuant to either (i) a legal service obligation or (ii) a contractual commitment, where such investment was made by the Company based on a reasonable expectation at the time that it would continue to serve the Ultimate Purchaser, and where the Company has reason to believe that such investment will not be recovered as a result of providing the requested transmission service.
CG&E may previously have been providing wholesale service to entities that may seek transmission service under the transmission tariff. Moreover, it was noted that, under the tariff, any attempt to recover stranded investment costs is subject, on a case-by-case basis, to the Commission’s review of the specific transmission service agreement, and the stranded costs included therein. The fact that PSI and CG&E may include such costs does not necessarily mean that they will be able to recover them: they still bear the burden of supporting the recovery of such costs, as discussed below.

The Applicants were directed to revise their transmission tariff to reflect the terms and conditions regarding stranded investment claims approved by the Commission in Entergy Services, Inc. Specifically, recovery of stranded investment costs must be based on a demonstration that when the company incurred such costs, it had a reasonable expectation at that time that the relevant agreement would be renewed. Furthermore, the customer’s liability may not exceed the contribution which the customer would have made to fixed costs under the current rate. The Applicants must also make a good faith effort to mitigate a customer’s stranded investment obligation. In addition, the Applicants may only attempt to recover stranded investment cost claims under the transmission tariff pertaining to agreements entered into up to the date of issuance of the order. Agreements entered into after the issuance of the order should explicitly address future potential stranded investment cost liabilities in the termination and notice provisions of such agreements.

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Philadelphia Electric Company (PECO) proceeding (Docket No. ER94-8-000). On October 6, 1993, PECO and Susquehanna Electric Company (collectively the Companies) submitted for filing a proposed change in rates for service to Conowingo Power Company.\(^1\) The proposed change is the addition of a termination charge, payable in certain instances if Conowingo reduces or terminates its purchases from the Companies.

A number of entities have intervened in opposition to the proposed change. In particular, the Maryland Public Service Commission (Maryland PSC) argued that its authority over Conowingo’s retail rates could be thwarted if the Commission approves the proposed termination charge. The Maryland PSC also argued that the Companies’ proposed termination charge should be distinguished from other cases where the Commission has allowed recovery of stranded investment costs in return for open access transmission: according to the Maryland PSC, the current filing would restrict, not increase competitive supply options. Finally, the Maryland PSC questions the reasonableness of the proposed termination charge.

It was argued that the recovery of stranded investment costs allowed in Entergy provides no basis for such recovery here since, in Entergy: 1) the Commission clearly stated that actual stranded costs must be determined on the facts of a specific case; and 2) Entergy, unlike the current proceeding, involved the filing of an open-access transmission tariff. Other intervenors argue that the Companies have not attempted to mitigate the size of the termination charge, question the reasonableness of the Companies’ expectation that Conowingo would remain a full-requirements customer, and take issue with the length of time (until 2004) estimated by the Companies as necessary for their load to absorb surplus capacity. Finally, it is claimed that the magnitude of the termination charge will prevent Conowingo from turning to alternative suppliers, regardless of whether the Companies offer transmission access.

In a related matter, the Companies filed open-access transmission tariffs on November 18, 1993.\(^2\)

In its draft Order (Docket No. ER94-8-000), the Commission wrote that as a general matter, it has long recognized that it is appropriate for utilities to include reasonable termination provisions, despite their obvious effect on wholesale competition, in power supply

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\(^1\) Since 1972, Conowingo has been a full requirements customer of PECO and Susquehanna.

\(^2\) Docket Nos. ER94-168-000, ER94-169-000, and ER94-170-000.
contracts to protect utilities from stranded costs.\footnote{In Kentucky Utilities Company (Opinion No. 169, 23 FERC ¶61,317; order on reh'g, Opinion No. 169-A, 25 FERC ¶61,205), for example, the Commission approved a five-year notice of termination and a three-year notice for smaller (25 MW or less) customers. On appeal, the court reversed as unsupported the Commission's finding of the need for a shorter duration notice for smaller customers. See Kentucky Utilities Company v. FERC, 766 F.2d 239 (6th Cir. 1985); see also Connecticut Light & Power Company, 55 FPC 1986 (1976) (rejecting seven-year notice provision); Arizona Public Service Company, 18 FERC ¶61,197 (1982) (approving seven-year notice provision).} While the Commission acknowledged that the circumstances presented in Entergy were different from those involved in the current proceeding, it is clear that Entergy did not limit stranded cost recovery to filings that involved open access transmission tariffs. Indeed, the Commission's explanation of the type of stranded cost recovery that would be allowed in Entergy reflected the Commission's expectation that stranded cost recovery would produce the same results as a reasonable notice provision under a power supply contract. In substance, Entergy's limitations on stranded investment cost recovery are the same as those applied historically by the Commission to termination charges.

The Commission's preliminary analysis of the proposed termination charge indicated that the proposed rates have not been shown to be just and reasonable, and may be unjust, unreasonable, unduly discriminatory or preferential, or otherwise unlawful. Finally, the Commission accepted the proposed termination charge for filing and suspended its effectiveness, pending a hearing. The hearing will address the question of whether a termination charge is appropriate and, if so, whether the charge proposed by PECO and Susquehanna is necessary and reasonable to allow them to plan their systems.