

## BILL ANALYSIS SHEET

**Date:** 1/21/09

**Prepared By:** Bond

**Title and Identifying Codes:** Georgia Nuclear Energy Financing Act, SB 31, LC 36 1203

**Description of Proposal:** Amend O.C.G.A. § 46-2-25 to add new subsection (c.1) dealing with accounting for and recovery of finance costs for nuclear construction.

**Revised:**

**Background:** Currently, the Commission has broad discretion in how the financing costs of construction of new electric generation are calculated and how they are recovered from ratepayers. Generally, the Commission has utilized a traditional regulatory accounting procedure for calculating financing cost. This procedure assumes that construction projects are financed with a blend of debt and equity. Finance costs are calculated such that the providers of debt and the providers of equity earn an appropriate return for the use of their capital during the construction period. Generally, the Commission has allowed recovery of finance costs, along with direct construction cost, from ratepayers only when the plant begins providing service.

Proposed new subsection O.C.G.A. § 46-2-25(c.1) would limit this discretion and mandate specific accounting, recovery, and rate design mechanisms that the Commission must use for nuclear construction. Major changes to the current system include:

1. Currently, financing costs are considered in conjunction with the rest of the revenue requirement. In other words, the Commission looks at the Company's total revenue picture, rather than piece parts in isolation, in deciding whether to increase or decrease any rates. Looking at piece parts in isolation is often referred to as 'single issue ratemaking.'

Subsection (c.1)(2) of the bill provides that the costs recovered under the bill cannot be "considered as revenue requirements nor be used to affect the outcome in any general rate case in which the utility is involved." (Page 2, lines 28-29). Subsection (c.1)(4) of the bill provides that the projected finance costs recovered under the bill are true-up after the fact to actuals. (Page 2, line 50). When these 2 subsections are read together, it appears that even if the Company has over-earned on its revenue requirement, the Commission could not use those over-earnings to offset any under-recovery of finance costs and would still have to allow ratepayers to be charged the full true-up amount.

2. Currently, the Commission has the authority to use any reasonable method for the recovery of finance costs. Traditionally the Commission has allowed recovery of financing cost, along with direct construction costs only when the plant goes on line. The costs are then depreciated over the useful life of the plant. In the case of a nuclear plant, that would likely be 40 to 60 years. Under this method, all of the costs are born by the customers actually receiving service from the plant. While the Commission has typically used this procedure, the Commission has the discretion to use other methods that would allow the Company to recover some or all of its finance costs during the construction period. Such potential methods would include, but would not be limited to: 'Normal CWIP' (projected construction work in progress is included in rate base like any other operating asset); 'Mirror CWIP' (pre-payments are placed in a liability account and are used to shave the peak off of the revenue requirement the first several years after the plant comes on line); or, 'CWIP with a True-up' (projected finance costs are charged to customers, but are then trued-up to actual). Under these three CWIP-like methods, during the construction period the ratepayers would make payments to compensate the Company for financing costs but would not be receiving service from the plant.

Subsection (c.1)(3) of the bill requires that all financing costs must be charged to ratepayers during the construction period, rather than over the life of the plant. (Page 2, lines 30-45). For financing costs incurred after the date that the Company begins recovering financing costs from ratepayers (for plants certified before July 1, 2009, that date would be January 1, 2011; for plants certified after July 1, 2009, the Company could pick any date that is within five years of the certification date), the Company would use a form of 'CWIP with a True-up.' For financing costs incurred before that date, the Company would recover those over a five-year period beginning on that same date. The bill prohibits the use of 'AFUDC,' 'Normal CWIP,' 'Mirror CWIP,' or other methods of recovery. It prohibits the Commission from changing the date that recovery would begin. And it prohibits the Commission from changing the period of time over which the costs are recovered.

3. Currently, the Commission has the authority to set a reasonable rate for the carrying costs. The Commission could use the utility's average weighted cost of capital if it was reasonable to do so, but the Commission could find that another rate was more appropriate based on the particulars of the project, such as the availability of federal loan guarantees or short term debt that would result in a lower cost of debt.

Subsection (c.1)(1) of the bill specifies that the carrying cost must be "the utility's average weighted cost of capital." (Page 1, line 22).

4. Currently, the Commission sets rates, including the recovery of the costs of financing, at levels that are "just and reasonable." This determination would include how the costs are allocated to different customers.

Subsection (c.1)(1) of the bill specifies exactly which customers are assessed the costs and it specifies how much of the costs they are allocated: "These financing costs shall

be recovered from each customer through a separate rate tariff and allocated on an equal percentage basis to standard base tariffs which are designed to collect embedded capacity costs.” (Page 1, lines 22-25). By specifying that the costs are allocated on an “equal percent basis”, the bill prohibits the Commission from determining that some classes of customers should pay higher or lower percents than other classes. By specifying that the costs are allocated to rates that are designed to collect “embedded” costs, the bill appears to exempt rates that are based on marginal pricing, such as Real Time Pricing. Marginally priced tariffs account for approximately 37.7% of all kWh sold and 20.9% of base revenues without fuel.

### **Pros:**

1. The rate design mandated by the bill provides a stair-step increasing of the rates that would reduce rate shock as compared to AFUDC.
2. Future customers (those receiving service after the plant goes on line) will pay lower rates as a result of pre-payments by current customers during the construction period.
3. Current customers whose cost of debt is less than Georgia Power’s (7.35%) and who will remain Georgia Power customers for a number of years may eventually receive a net benefit from the prepayment. For example, for the current certification case, a customer with a 0% cost of debt could start receiving a net benefit from the pre-payments in 2027 (if you ignore the impacts of tax pre-payment). A customer with a 7.35% cost of debt would break even in 2077. If you assume that Georgia Power customers have an average cost of debt of 0%, then the pre-payments could save ratepayers \$300 million (if you ignore the impacts of tax pre-payments).
4. The early recovery of financing costs will reduce the possibility of a down-grade in the Company’s bond rating. A lower bond-rating can increase the Company’s cost of debt. A higher cost of debt can result in higher rates to customers.
5. Limiting the allocation of financing costs to rates designed to recover embedded capacity costs reduces, and in some cases eliminates, the amount of the financing costs charged to certain large industrial and commercial customers, making them more competitive.

### **Cons:**

1. Under current law, the Commission, as the expert ratemaking agency, has the discretion to use reasonable accounting, recovery, and rate design mechanisms, including, but not limited to, the ones set forth in the bill. The bill removes the current flexibility to consider the circumstances of a particular case and mandates that the Commission use particular mechanisms even if the Commission finds that others might be more appropriate.
2. The rate design mandated by the bill would not reduce rate shock as much as Mirror CWIP would. Both provide a stair-step increasing of the rates during the construction period, but Mirror CWIP also reduces the in-service revenue requirement when it is at its peak.
3. The pre-payments would force current customers to subsidize future customers.

4. Customers do have a cost of money. When ratepayers' cost of money is taken into account, the pre-payments cost rate payers at least \$218 million in net present value dollars over the life of the plants. Current customers whose cost of debt (or whose opportunity cost to invest) is more than Georgia Power's (7.35%) will never receive a net benefit from the prepayment. They will, in fact, have a net harm from the pre-payments. Most ratepayers have a much higher cost of debt than 7.35%. Even before the current economic crisis, for example, approximately 50% of families carried credit card debt. The mean balance was \$5,000 and the average interest rate was almost 14%. Using a 14% consumer's opportunity cost of capital, pre-payments cost ratepayers \$740 million more in net present value dollars over the life of the plant. Further, it is unreasonable to ignore the \$400 million income tax impact of the pre-payments on ratepayers. It is also unreasonable to ignore the sales tax impacts. Georgia Power is indifferent to the pre-paid taxes – they are a pass through for them. But ratepayers are not indifferent. It is real money that they must pay years before it would otherwise be due.
5. The Company is not currently in danger of having its bond rating down-graded, so pre-payment is not necessary at this time. If and when it is shown to be necessary, the Commission can provide for it at that time, but only to the extent that it is necessary so that the negative effects of pre-payments on ratepayers are minimize.
6. Limiting the allocation of financing costs to rates designed to recover embedded capacity costs means that approximately 37.7% of all kWh sold and 20.9% of base revenues are exempt from the allocation. Costs that could have been allocated to certain large industrial and commercial customers, would have to be allocated to remaining customers, thus increasing their rates even more.
7. Pre-payment reduces the company's incentive to get the plant in service on time. The bill allows the Company to start receiving profit payments years before the plant is done. This reduces the pressure on the Company to finish the plant on schedule. Delay will cause the cost of the plant to escalate.

### **Fiscal Impact on State Budget and Commission Operations:**

The State Government is also an electric customer. State agencies and authorities that pay rates designed to collect embedded costs would have to make the pre-payments.

### **Economic Impact on Business & Consumers:**

Customers would have to pay \$1.6 billion in finance costs, an additional \$400 million for gross up for income taxes, plus any applicable sales taxes during the construction period before the plants are completed. On a net present value basis, current customers would be hurt by pre-payments by \$218 million or more over the life of the plants. Generally, an individual customer would need to take two years of service after plants come on line for every one year of prepaying financing cost just to recoup their pre-payment in nominal dollars. A current customer with a cost of debt of over 7.35%

would never breakeven. Customers who join the system after the plants come on line would benefit.

**Attachments:** Attached is an illustration in nominal dollars (i.e., dollars that do not factor in the cost of money) of 3 possible ways to recover construction finance costs.