

Stranded Costs and Stranded Values

- Measurements of Stranded Costs and Stranded Values result from comparisons regulated rates for generation services with competitive market prices for such services.
- Recognition of the potential for Stranded Value is a Necessary corollary to the consideration of Stranded Costs.
 - ⇒ **Stranded Costs** represent costs that are recoverable by a utility under existing regulatory policies that are not recoverable under competitive market pricing of services if current regulated rate levels are above competitive market prices.
 - ⇒ **Stranded Value** represents profits in excess of a regulated fair rate of return that the owners of regulated generation resources we be derive if they are permitted to price energy and capacity services on the basis of market values that are in excess of current cost-based ratemaking levels.

Stranded Costs and Stranded Values

- **Stranded Costs** result when competitive market price is less than the regulated rate for the same service. In simple terms that relationship can be represented as follows:

$$SC = CMP - RP$$

where:

SC = Stranded Costs

CMP = Competitive Market Price

RP = Regulated Price

and

$$CMP < RP$$

- **Stranded Values** result when the competitive market price is greater than the regulated rate for the same service. In simple terms that relationship can be represented as follows:

$$SV = CMP - RP$$

where:

SV = Stranded Value

CMP = Competitive Market Price

RP = Regulated Price

and

$$CMP > RP$$

Stranded Costs and Stranded Values

- There are no Stranded Costs or Stranded Values for electric utilities in Virginia today, because there is no competition for retail electric services in Virginia.
- Stranded Costs for a utility can only exist where competition replaces what was once provided as a monopoly service.
- Before a monopoly service can be replaced by competitive offerings there must be assurance of a viable competitive market structure, i.e.,
 - ⇒ **Multiple Alternative Suppliers** of the service;
 - ⇒ **No Market Dominance** or single supplier having the ability to directly influence or control the market price; and
 - ⇒ **No Substantial Barriers** to market entry and exit by competitive suppliers.
- Stranded Cost and Market Power issues are *highly inter-related* and must be addressed within a consistent framework.

Stranded Costs and Stranded Values

- The objectives of efforts to identify Stranded Costs should be twofold:
 - ⇒ To ensure that utility shareholders are not financially harmed by the opening of generation markets to competition.
 - ⇒ To protect consumers against potential *Windfall Profits* for utility shareholders where the market value of generation assets is greater than that reflected on the books of the utility for ratemaking purposes.
- The regulatory treatment of Stranded Costs and Stranded Values will strike an equitable balance between the interests of shareholders and ratepayers

if, and only if,

shareholders are no better-off and no worse-off than they would have been under a continuation of traditional regulatory policies and practices.

- Utilities must not be permitted to utilize generation assets with market values greater than depreciated book value to make competitive sales of power Unless all profits in excess of a regulated rate of return are passed back to consumers.

Stranded Costs and Stranded Values

- Efforts to measure Stranded Costs must compare:
 - ⇒ The *Expected Present Value* of the stream of revenues that a utility's generation assets will produce in a competitive market over the remaining useful lives of those assets.
 - with
 - ⇒ The *Regulatory Value* of those assets at the time the market for generation services is opened to competition.

Stranded Costs and Stranded Values

- Estimates of the expected present value of the future stream of revenues that a utility's generation assets will produce are by their very nature highly assumption driven and speculative.
- The value of a utility's generation assets in a competitive market environment is dependent upon expectations regarding future market conditions; where:
 - ⇒ Demands for generation are expected to fluctuate at least hourly, daily, monthly, and seasonally; and
 - ⇒ Changes in the costs fuels and the availability of generation resources may be unpredictable.

Stranded Costs and Stranded Values

- Estimates of future market prices for generation must rely on *assumptions* regarding such factors as:
 - ⇒ Future demands for generation by hour, day, month and year;
 - ⇒ Generating unit maintenance schedules, forced outages, and availability for all generators that may potentially serve the market;
 - ⇒ Generating capacity additions and retirements and their timing (including additions of on-sight generators);
 - ⇒ Future prices for all fuels used in generation;
 - ⇒ Expected costs and lead times for constructing new generating units;
 - ⇒ The extent of transmission constraints on energy supply; and
 - ⇒ Costs of transmission services for generation imported from other areas.

Stranded Costs and Stranded Values

- The most conceptually consistent approach to measurement of the future value of a utility's generation assets is obtained when the utility sells its generation resources through an open competitive bidding process.
 - ⇒ Estimates of the future value of generation assets submitted in a competitive bidding process that must be backed by real dollar commitments are the only estimates of the value of generation assets that should be accorded significant weight.
 - ⇒ If you trust that competition in generation markets will provide cost savings to consumers, then you should also trust the sale of a utility's generation resources through a competitive process will produce a true reflection of the market value of a utility's generation resources.

Stranded Costs and Stranded Values

- Determinations of Stranded Costs through litigation typically provide consumers with the benefit of only average expectations regarding the present value of generation resources.
- Determinations of Stranded Costs through open competitive bidding processes provide consumers with the benefit of the most favorable of bidder expectations.
- Determination of Stranded Costs through open competitive bidding for generation can also address market power issues.
 - ⇒ Due to constraints on transmission system imports of power from outside the state are likely to be limited.
 - ⇒ Auctioning of generation resources can be used to dilute the existing market power of incumbent utilities.