WORK SESSION DOCUMENT

GOVERNOR'S COMMITTEE ON ENERGY CHOICE

Technical Working Group on Consumer and Investor Economic Impacts

Summary of Policy Recommendations to be Presented for Consideration by the Governor's Committee on Energy Choice

The Technical Working Group on Consumer and Investor Economic Impacts (TWG on Economic Impacts) has been tasked with addressing the following issues related to the Energy Choice Ballot Initiative ("Question 3" or "ECI"). This list is illustrative rather than exhaustive:

Determine extent and timing of divestiture of supply assets

Determine process for divesting the utilities of supply assets (generation, power purchase agreements, and associate assets and contracts, including hydropower and PURPA impacts)

Determine process for divesting the utilities of other assets, contracts, and obligations associated with restructuring

Determine appropriate processes for calculating and recovering stranded costs and

Formulate plans to mitigate potential impacts of restructuring on employment

Identify entities responsible for managing job losses and vocational rehabilitation

Pursuant to Executive Order 2017-03 and Executive Order 2017-10, and in accordance with the directive given at the November 7, 2017 meeting of the Governor's Committee on Energy Choice, during which Chairman Mark Hutchison instructed Committee Technical Working Groups to prepare summaries and policy recommendations for consideration by the full Committee, the Technical Working Group on Economic Impacts hereby reports the following summary and recommendations.

1. An Effective and Equitable Process for Identifying, Allocating, Calculating, and Recovering Costs Associated with Electric Market Restructuring Will be Essential for the Successful Implementation of the Energy Choice Initiative in Nevada.

STATEMENT OF THE ISSUE: The experiences of other states that have implemented energy market restructuring consistently demonstrate that divestiture of incumbent utility assets, "stranded asset" costs and other transition costs are among the most challenging issues associated with market restructuring. Information provided to this TWG, as well as published scholarship on the issue and prior research conducted in Nevada, all generally support the conclusion that identifying, allocating, calculating, and ultimately recovering stranded costs

associated with divestiture has historically presented significant challenges to states exploring the possibility of market restructuring.

For example, when Texas began its restructuring process after the passage of Senate Bill 7, addressing the "stranded assets" issues was one of the chief concerns associated with implementing a restructured, competitive energy marketplace: "The largest problem threatening the smooth transition from a regulatory market to a competitive market is stranded cost recovery. Every state that has deregulated the electric utility industry has grappled with this issue…it is therefore of extreme importance to determine who pays for stranded costs, how stranded costs are calculated, and how stranded costs are collected."[1]

The Federal Energy Regulatory Commission (FERC), in its landmark Order 888, which helped to pave the way for energy market restructuring in numerous states, concluded, "The most critical transition issue that arises as a result of [FERC]'s actions in the rulemaking is how to deal with the uneconomic sunk costs that utilities prudently incurred under an industry regime that rested on a regulatory framework and a set of expectations that are being fundamentally altered."[2] Emphasizing the difficulties that arise with regard to stranded costs issues, the Congressional Budget Office in 1998 stated, "Determining the correct figure for stranded costs, deciding how much of them to compensate, and figuring out how that compensation should be paid are difficult issues, which are slowing progress toward restructuring in many states."[3]

There is a great deal of published scholarship and research surrounding state approaches to stranded costs. One notable published summary[4] of the issue highlights the difficulties associated with stranded assets policy, and touches on general approaches states have taken with regard to stranded costs:

> "Because of their magnitude, stranded costs created a great deal of political tension. The arguments [come] down to fairness and equity compared to economic efficiency…In general, states allowed utilities to recover all or some significant portion of their stranded costs and gave utility commissions guidance as to how to decided what was or was not recoverable…Almost every state legislature chose a definition of stranded costs that referred to costs that were legitimate, net, verifiable, and unmitigated. Utility commissions were left to decide on the exact definitions of those terms."

In Nevada, similar conclusions have been reached regarding the challenges that are inherent in identifying, allocating, and calculating stranded costs. In 1997, the Nevada Legislative Counsel Bureau, in Bulletin 97-11, thoroughly examined the issue of electric markets restructuring, including the specific issues of stranded costs.[5] The LCB's report concluded, "The issue of

[1] *Implementation of Senate Bill 7: The Implication of Stranded Costs Recovery for Residential Electric Utility Consumers*. Scott, Natalie. Baylor Law Review (Winter, 2000). 52 Baylor L. Rev. 237, at 247.

[2] *Special Commentary: Recovery of "Stranded Costs" by Utilities.* Greenbaum, Roger A. 80 American Law Reports 6th (2012) at 20.

[3] Greenbaum at 21, citing *Electric Utilities: Deregulation and Stranded Costs*. Cohen, Gail. Congressional Budget Office (1998).

[4] *A Comprehensive View of U.S. Electric Restructuring with Policy Options for the Future*. Brown, Matthew H. and Sedano, Richard P. National Council on Electricity Policy. (June, 2003). At 30.

[5] *Competition in the Generation, Sale, and Transmission of Electric Energy*. Legislative Counsel Bureau Bulletin No. 97-11 (January, 1997).

stranded costs is one of the most important topics in restructuring." Despite the importance of the issue, however, the report concluded that there was no ultimate consensus reached on how to appropriately address stranded costs, as "there were diametrically opposed recommendations about recovery of these costs."[6] Notably, the sole recommendation from the LCB's report was for the 1997 Legislature to "Appoint a six-member interim study subcommittee to conduct further investigation into all aspects of restructuring the electric industry."

Most recently, in its *Final Report on the Energy Choice Initiative*, the Public Utilities Commission of Nevada (PUCN) concluded that "Perhaps the most important topic related to potential costs of implementing the Energy Choice Initiative is the issue of divestiture of utility assets and liabilities." [7] The PUCN's report discusses in detail the "spectrum of views regarding divestiture, including whether any of Nevada's public utilities would have to divest of their generation assets and/or long-term power purchase agreements," and notes that analyzing and quantifying stranded costs is made difficult by the fact that it is "not a linear conversation" and by the fact that "market conditions regarding the costs of generating, transmitting, and delivering electricity are constantly changing." [8]

The PUCN's final report on ECI identifies a general range in costs associated with stranded assets: "The cost estimates related to divestiture that the PUCN Workshop Proceeding participants presented ranged from…zero dollars…up to approximately 7 billion dollars," noting that "no participant attempted to monetarily quantify the benefits." The report estimates a total cost of approximately $4.074 billion, inclusive of regulatory and stranded asset costs. [9]

In short, the questions that arise with regard to divestiture of assets and liabilities, allocating and quantifying stranded costs and transition costs, and ultimately the question on how to recover those costs, are difficult questions to answer, and consensus on the best approach is not arrived at easily.

SUMMARY OF PRESENTATIONS: The Technical Working Group (TWG) on Economic Impacts has met five times since the working group was formed, and has received presentations from the following entities on topics related to stranded costs:

I. **June 21, 2017** – Kevin Geraghty, Senior Vice President, Energy Supply, representing NV Energy, presented an overview of the major assets held by NV Energy. Mr. Geraghty discussed NV Energy's generation assets and also reviewed the utility's power purchase agreements (PPAs). He also discussed potential transition costs (establishing provider of last resort, creating customer switching mechanism, and creating a new FERC-approved tariff for transmission operations), potential stranded costs, costs associated with maintaining public policy initiatives, and other costs associated with taxes and fees that NV Energy currently pays but may not pay in a restructured market (estimated at $232.6 million) (*NV Energy Presentation 06/21/2017* at 13, 14, and 18). He also described the divestiture process in New

[6] Id. At 52

[7] *Energy Choice Initiative Final Report: Investigatory Docket No. 17-10001*. Public Utilities Commission of Nevada. (April 2018). At 39-40

[8] Id. At 51

[9] Id. At 50, 66.

Hampshire and recommended consulting New Hampshire's approach as one option for Nevada.

II. **August 17, 2017 -** Clay MacArthur, Vice President, representing Deseret Power Electric Cooperative, presented an overview of Deseret Power's operations and generating assets, and discussed the Mt. Wheeler service area as well as a comparison of utility structures and residential rates. His presentation concluded with the assumptions that if ECI is approved, and there is no cost shifting or subsidizing of stranded costs, all utilities and ratepayers are subject to equal stranded costs, and that NV Energy's stranded costs total approximately $7.4 billion, then there could be a 30% increase to the energy component of Deseret Power's rates (*Deseret Power Presentation 08/17/2017* at 10).

Hank James, Executive Director of Nevada Rural Electric Association (NREA), pointed out that Nevadans for Clean Energy Choices, proponents of the ECI, have stated that if the initiative passes, implementation "May include economic and orderly divestiture of generation and limits on corporate affiliates serving as Retail Energy Providers." He identified transition costs for NREA owner-members in a competitive market to include Alternative Power Providers' profit margin (10-15%), unspecified transmission and retail wheeling costs, NREA's existing PPA divestiture/liquidation costs ($1 billion +), and other miscellaneous costs (*NREA Presentation 08/17/2017* at 18).

Jayne Harkins, Executive Director of the Colorado Commission of Nevada (CRC), presented an overview and history of the CRC and the structure of federal and state hydropower contracts in general. Ms. Harkins pointed out that "CRC, Boulder City, and other Nevada entities hold long-term contracts with the federal Power Marketing Agency for hydropower." (*CRC Presentation* at 18). Ms. Harkins also pointed out that the "ECI has raised questions regarding Nevada's ability to continue to benefit from low-cost, renewable federal hydropower" and regarding the "viability of CRC's long-term hydropower contracts". (*CRC Presentation* at 19). Ms. Harkins also stated to the TWG that she did not believe CRC would have any stranded assets should ECI be approved.

John Williams and Celeste Schwendiman, representing the Department of Energy's Bonneville Power Administration (BPA), presented to the TWG on the provisions of BPA contracts to provide energy, specifically with regard to the long-term aspects of BPA's contracts which serve to provide rate guarantees. Ms. Schwendiman stated that she did not believe BPA's contracts had termination provisions and that it would likely be a lengthy process to terminate BPA contracts. (See *Aug. 17, 2017 TWG Meeting Minutes* at 3).

III. **October 17, 2017 –** Mark Warden, Senior Attorney representing NV Energy, presented generally to the TWG on NV Energy's long-term contracts. He generally discussed ECI's potential impacts to long-term agreements, discussed the possibility

of assigning contracts and timing for restructuring, and stated that NV Energy "would incur stranded costs equal to a termination payment, or upon assignment, the remaining value of the agreement less any compensation received, plus any transaction costs." (*NV Energy Presentation 10/17/2017* at 4).

Mr. Warden stated that NV Energy's power purchase agreements total $6.7 billion, and that gas transportation agreements with four pipeline companies are worth approximately $468 million. He also stated that two long-term service agreements contain termination provisions, with fees associated (either a percentage of the remaining value of the agreement or the entire fee, depending on the agreement), but that the power purchase agreements and natural gas transportation and storage agreements do not provide for termination for convenience (*NV Energy Presentation 10/17/2017*, at 5, 7). He estimated that the cost to terminate long-term service agreements would be about $9 million.

Mr. Warden concluded that any ECI legislation should allow NV Energy to honor its contractual commitments and avoid creating circumstances that would damage the reputation of the State of Nevada or NV Energy or harm NV Energy or its counterparties. (See generally *Oct. 17, 2017 TWG Meeting Minutes* at 2-3).

IV. **February 6, 2018 –** Jesse Newman, representing IBEW Local 396, and Hunter Stern, representing IBEW Local 1245, presented to the TWG on issues related to collective bargaining agreements and divestiture under a restructured market. Mr. Newman estimated that approximately 400 IBEW jobs could be lost as a result of ECI, and that "deregulation will impact additional IBEW members and workers throughout Nevada." (*IBEW Presentation 02/06/2018* at 7, 8).

Carolyn Barbash, Vice President, Energy Market Policy, representing NV Energy, presented to the TWG generally on ECI's impacts on the Nevada workforce. Ms. Barbash stated that exact impacts of ECI on employees are "uncertain as a plan for implementing the Constitutional Amendment has not been provided." Ms. Barbash provided "high-level estimates based on assumptions," and estimated that "divestiture of energy supply assets and exit from the role of Electric Provider would result in at least a 30% reduction in NV Energy's workforce primarily in generation, renewables and energy efficiency, resource optimization, resource planning, transmission service and balancing, customer service, and support organizations." (*NV Energy Presentation 02/06/2018* at 2, 3).

Ms. Barbash also estimated that service and retention costs associated with workforce downsizing would include approximately $20 million in severance costs for 311 non-represented employees, $29 million in severance costs for 368 represented employees, and retention costs ranging from $4-7 million. (*NV Energy Presentation 02/06/2018* at 5).

RECOMMENDATION:

A. Should ECI be approved in November, the Nevada Legislature should, as soon as practicable, commission further study and investigation of the issues implicated by divestiture, particularly calculating, allocating, and recovering stranded asset costs and other transition costs, including but not limited to costs arising from impacts to the incumbent utility, impacts on the workforce, and other aspects of implementing a restructured market.