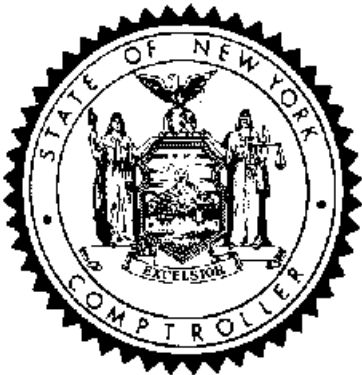


State of New York
Office of the State Comptroller
Division of Management Audit

LONG ISLAND POWER AUTHORITY

**STAFF STUDY: DISPOSITION OF
THE SHOREHAM NUCLEAR
POWER PLANT**

REPORT 95-D-38



H. Carl McCall
Comptroller



State of New York Office of the State Comptroller

Division of Management Audit

Report 95-D-38

Mr. James F. Gill
Chairman
Long Island Power Authority
200 Garden City Plaza
Garden City, NY 11530

Dear Mr. Gill:

The following is our study of the Long Island Power Authority's accomplishment of its mandate to decommission the Shoreham Nuclear Power Plant, lower utility costs on Long Island and find a non-nuclear use for the Shoreham property.

This study was performed pursuant to the State Comptroller's authority as set forth in Article X, Section 5 of the State Constitution. Major contributors to this report are listed in Appendix A.

*Office of the State Comptroller
Division of Management Audit*

February 21, 1996

Executive Summary

Long Island Power Authority Staff Study: Disposition of the Shoreham Nuclear Power Plant

Scope of Study

The Long Island Power Authority (LIPA) was established under Chapter 517 of the Laws of 1986 (LIPA Act) in response to the public's demand that New York State safely dismantle the Shoreham Nuclear Power Plant (Shoreham) and find a way to reduce Long Island's energy costs. LIPA began its existence in January 1987. The Legislature authorized LIPA to do the following: acquire all and any part of Long Island Lighting Company's (LILCO) securities or assets; close and decommission Shoreham; investigate and develop non-nuclear alternative uses, if any, for Shoreham; and encourage energy conservation efforts to the fullest extent possible in LILCO's service area. LILCO claims that Shoreham, which is located on part of a 500-acre LILCO-owned site in Suffolk County, cost \$5.6 billion to build. Shoreham was never used to generate electric power for commercial purposes, and was approved as decommissioned by the Nuclear Regulatory Commission in May 1995. LILCO reported that it paid decommissioning, closure and property costs of \$965 million. LIPA has not, thus far, obtained public acceptance of possible uses of the now defunct plant.

Our study period covered the period January 15, 1987 through August 31, 1995, during which time LIPA received \$15.3 million of State appropriations and \$671,000 in interest revenues from such appropriations.

Our study addressed the following issues related to LIPA and its management of issues related to Shoreham:

- ! What are the costs associated with Shoreham, and who is paying them?
- ! Has LIPA accomplished what it was mandated to do, including lowering Long Island ratepayers' utility costs?
- ! What is LIPA's future role?

Study Observations and Conclusions

LILCO electric rates are among the highest in the nation. The company projects that paying for Shoreham-related costs will account for about 27 percent of the average customer's utility bill in 1995. Our study determined that LILCO ratepayers are paying for Shoreham-related debts (categorized by LILCO as a "regulatory asset") amounting to \$3.5 billion as of December 31, 1994, and for plant maintenance and tax costs budgeted at about \$69 million in 1995.

While LIPA did successfully decommission Shoreham, it has not reached its other goals of lowering utility costs and finding a use for the closed plant.

LIPA was created with broad statutory powers to respond to the "threat to the economic well-being" of residents and businesses on Long Island posed by LILCO's huge investment in Shoreham. However, although feasibility studies projected that LIPA's acquisition of LILCO would lower utility rates, no takeover occurred. Instead, LIPA, LILCO, the Public Service Commission and the Governor's Office opted for a settlement, whose terms arranged for LILCO customers to finance LILCO's restoration to financial health. A Rate Moderation Agreement was enacted to constrain future rate increases as much as reasonably possible. However, the result of this and other agreements is that, in 1994, average LILCO residential customers each paid an additional \$424 in their utility bills (average commercial customers paid an extra \$3,735) to pay for this failed venture. Additionally, LIPA has not been able to implement a practical, non-nuclear use for the idle plant. (See pp. 3-16)

Initiatives begun after the period covered by this study indicate that State leaders are again discussing strategies for some form of a takeover of LILCO. To reduce electric rates in a prudent and equitable manner - the objective of such a takeover - policymakers must determine how to achieve long-term financing of the Shoreham debt within the regulatory structure for New York utility companies. With a new Board of Trustees appointed as of September 1, 1995 LIPA may still participate in plans to provide economic relief to LILCO ratepayers. However, consideration should also be given to assigning LIPA's advocacy role to one of the other existing entities whose mission includes looking after the interests of utility consumers. (See pp. 17-19)

Comments of LIPA Officials

LIPA officials generally agree with the discussion of issues and background information cited in this study. LIPA officials in their comments provided updated information to clarify and explain their actions with respect to high electric rates on Long Island and the Shoreham - related costs that now beset LILCO and its customers. We have considered their comments in preparing this report.

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The comments of Agency Officials are not available in an electronic format. Please contact our Office if you would like us to mail you a copy of the report that contains their

Introduction

Background

The Long Island Lighting Company (LILCO) announced in April 1965 that it intended to build a nuclear plant at Shoreham, New York, and began construction in 1973. The construction of this facility over the course of the next decade was marked by numerous delays and dramatically increased costs. The project was also impacted by difficulties encountered by the nuclear industry nationwide, including the need to meet a growing list of regulatory requirements. There was a steady erosion of support for the project on the part of local government leaders in response to the concerns about LILCO's plans to operate a nuclear facility on Long Island. Wholly-owned by LILCO, Shoreham was completed in 1985 and tested at 5 percent operating capacity before being abandoned as a commercial nuclear power plant. The Legislature created the Long Island Power Authority (LIPA) in 1986 to undertake, among other tasks, the decommissioning of Shoreham. Decommissioning was begun in June 1992 and completed in December 1994.

LIPA was established under Chapter 517 of the Laws of 1986 (LIPA Act), and began its existence in January 1987. Originally, LIPA's Board of Trustees consisted of nine members: five were appointed by the Governor, and four were appointed by the State Legislative leaders. As of September 1, 1995, new legislation increased the number of Trustees serving on the Board to 15 members. The original legislation authorized and empowered LIPA to acquire all and any part of LILCO's securities or assets; close and decommission the Shoreham Nuclear Power Plant; investigate and develop non-nuclear alternative uses, if any, for Shoreham; and encourage energy conservation efforts to the fullest extent possible in LILCO's service area. LIPA officials indicate that they also serve as a ratepayer advocate.

In fiscal year 1994-95, LIPA had a reported operating staff of 17 employees and a budget of approximately \$1.8 million. Of this amount, \$850,000 came from State appropriations, and the remainder came from LILCO in payment for Shoreham's decommissioning costs. The legislation that established LIPA stated that the authority is required to repay all the State appropriations it receives for its operations. Therefore, according to the terms of the August 1987 repayment agreement between LIPA and the Division of the Budget, LIPA currently owes about \$15.3 million in State appropriations and an additional \$671,000 in interest income. LIPA is supposed to repay these appropriations from excess revenues or from monies from the sale of bonds.

Study Scope, Objectives and Methodology

We conducted a study of the Long Island Power Authority and issues related to the Shoreham nuclear power plant for the period January 15, 1987 through August 31, 1995. Our study objectives included the following: determining the costs associated with the Shoreham Nuclear Power Plant, who is paying them and assessing LIPA's accomplishment of its mission and its future role in Long Island. LIPA's mission includes acting to take over LILCO or acquire its assets if that would result in rates lower than otherwise would have been under LILCO; decommissioning the Shoreham Nuclear Power Plant and finding an alternate non-nuclear use, if any, for the facility.

To accomplish our study objectives, we reviewed pertinent documentation concerning Shoreham's history and LIPA's role in resolving issues related to Shoreham, including all applicable laws, procedures, agreements, decommissioning plans, conversion plans, the Politics of Nuclear Power report, newspaper articles, and any other alternative plans. We examined all documentation related to a complete disclosure of Shoreham's costs and their impact on LILCO ratepayers. We also contacted officials at the State Energy Office and the Public Service Commission (PSC). In addition, we interviewed LIPA and LILCO officials to assess their interests in developing practical uses of the Shoreham Nuclear Power Plant.

PSC is the source of much of the financial data contained within the report. PSC is the State regulatory agency that oversees investor-owned utilities and reviews the propriety of proposed utility actions, including rate increases.

Response of LIPA Officials

Draft copies of this study were provided to LIPA officials for their review and comment. Their comments have been considered in preparing this report and are included in Attachment B.

LIPA officials generally agree with the discussion of issues and background information cited in this study. LIPA officials in their comments provided updated information to clarify and explain their actions with respect to high electric rates on Long Island and the Shoreham - related costs that now beset LILCO and its customers.

The Troubled History of the Shoreham Nuclear Power Plant

LILCO built the Shoreham Nuclear Power Plant (Shoreham) to generate additional electric power for its Long Island customers. Shoreham is located on an 80-acre developed portion of a 500-acre LILCO-owned site in the Town of Brookhaven, Suffolk County, on the north shore of Long Island. The 11 acres on which the Shoreham facility is located contain buildings to house the facility's reactor, radiation waste storage and turbine, as well as a number of control and administrative buildings. The Shoreham facility, which LILCO claimed it spent \$5.6 billion to build and license, was never put in service for commercial use. LIPA was established in 1986 to decommission the plant, find some other non-nuclear use, if any, for it and reduce energy rates for LILCO customers. While the plant has been approved as decommissioned by the Nuclear Regulatory Commission (NRC) in May 1995, LIPA has thus far had little success with the introduction and implementation of its other goals under the Act. LILCO ratepayers continue to pay among the highest utility rates in the country, with a significant dollar amount attributable to the costs of this failed venture.

The origins of Shoreham date to April 1965, when LILCO first proposed preliminary plans to spend between \$65 and \$75 million to build a nuclear facility to generate supplemental electric power to meet the growing demand from its Long Island customers. Two years later, LILCO management selected a 540-megawatt (MW) unit for Shoreham at an estimated cost of \$124 million and an estimated completion date of Spring 1973. In 1969, LILCO increased the size of the unit to 820 MW plant with a cost of \$217 million and a completion date of 1975. According to LILCO officials, the company increased the size of the unit to reflect economies of scale and meet the growing demand for energy. LILCO was granted a permit to begin plant construction in 1973. By that year, LILCO had increased estimated construction costs to \$560 million, and advanced the completion date to 1977.

The project was subject to numerous delays, and Shoreham's costs increased dramatically. In 1983, major construction was completed. The final cost was reported to be \$5.6 billion. LILCO attributed the majority of the increased cost and the delay to changes required to put the plant in compliance with increasingly stringent Federal regulatory requirements for nuclear projects. LILCO officials noted that the need for design changes was not uncommon in the nuclear industry at the time. These officials also contend that local government (Suffolk County) contributed to delay by not participating in the development of an acceptable evacuation plan. Further delay resulted in LILCO's repeated borrowing to complete the project, incurring formidable

interest charges in the process. Carrying costs (cost of debt) totaling \$2 billion represent almost 36 percent of the \$5.6 billion total cost.

In 1983, a LILCO test of the plant's operating systems (non-nuclear components) resulted in failure of the plant's back-up diesel generators. In 1985, the NRC issued LILCO a license to begin low-power testing (up to five percent of capacity) of the entire Shoreham plant. Because of the nature of nuclear operations, however, even low-power testing contaminates the facility, including fuel and affected component systems, through exposure to radioactivity. Nonetheless, LILCO management decided to conduct such testing in August 1985. According to LILCO officials, management believed at that time that a full operating license was probable, and that further delay would only add to the plant's cost.

The Public Service Commission (PSC), voted in December 1985 to disallow \$1.4 billion of Shoreham's total cost which it determined to be the result of management's errors. Thus, LILCO stockholders had to absorb the \$1.4 billion in costs; LILCO, ratepayers are ultimately responsible for the remaining \$4.2 billion from its customers (in the form of significantly higher utility rates) which are spread over a 40-year period.

The higher than anticipated costs of building Shoreham, the occurrence of operating problems during testing in 1983 and growing dissatisfaction with LILCO's performance had made Long Islanders unhappy about paying for LILCO's huge investment in this facility and doubtful of LILCO's ability to operate it. Further, the public had become increasingly concerned about safety issues. In April 1986, a serious nuclear accident at Chernobyl in the Soviet Union resulted in numerous deaths, the evacuation of 49,000 persons and a radioactive cloud that dispersed throughout Europe and across the Atlantic. It is widely believed that the explosion at this plant, which had ramifications far greater than the overheating at Three-Mile Island in Pennsylvania in 1979, heightened Long Island residents' fears about the inherent risks of nuclear power. In September 1985, Hurricane Gloria struck Long Island, causing widespread damage and power outages. LILCO customers reacted angrily to what they regarded as the utility's inadequate response to customers' service needs in the wake of this destructive storm. According to LIPA, in response to local government and public pressure to address the economic and safety issues posed by Shoreham, the Legislature enacted Chapter 517 of the Laws of 1986 (LIPA Act) in July of that year to establish LIPA as a corporate municipal entity, effective January 1987.

The Legislature stated that LILCO's investment in the Shoreham facility had created a significant increase in the costs of electric power for Long Island ratepayers. The LIPA Act stated that the projected rate increases required to pay for Shoreham's construction would likely continue to occur if the plant

were placed in service. Therefore, the LIPA Act stated that LIPA is empowered to do the following:

- ! review the feasibility of a LILCO takeover if it determines that the rates would be equal to or less than the rates which would result if LILCO were to continue in operation;
- ! decommission the Shoreham Nuclear Power Plant;
- ! investigate and develop non-nuclear uses for Shoreham, if any; and
- ! encourage energy conservation efforts to the fullest extent possible in the LILCO service area.

The LIPA Act states that LIPA has the power to initiate the acquisition of LILCO if LIPA determines that such a takeover would result in rates that would be equal to or less than LILCO's rates. Four different studies have been conducted to determine the feasibility of a LILCO buy out; several of these studies projected that a LIPA takeover would result in lower rates for LILCO customers. In March, April and May 1988, LIPA made offers of \$8.75, \$10 and \$12 per share, respectively, for all the outstanding shares of LILCO stock. The LILCO Board of Directors rejected all three offers. LIPA would not make additional buy out proposals until October 1994 and June 1995. LILCO has not accepted any of LIPA's buy out proposals.

Governor Cuomo, representing New York State, negotiated a first Settlement Agreement with LILCO in 1988, and a final Agreement in 1989, in which LILCO agreed never to operate Shoreham as a nuclear facility. LILCO agreed to transfer the plant and certain properties on the site to LIPA so that LIPA could proceed to contract with the New York Power Authority (NYPA) for the plant's decommissioning. An Asset Transfer Agreement specified the properties to be transferred. In return, the parties agreed to return LILCO to investment-grade financial condition as a stockholder-owned utility, to allow LILCO a temporary rate increase of 5.4 percent and to arrange for the resolution of certain litigation against LILCO. The means of restoring LILCO to good financial condition were specified in a Rate Moderation Agreement (RMA) approved in April 1989 by the PSC. The Settlement (provisions contained in both the Agreements) was approved by the PSC in April 1989; it was approved in June 1989 by LILCO's Board of Directors and shareholders and by LIPA's Board of Trustees. The terms of the Settlement and the RMA will be discussed in detail in the section of this report entitled "Paying the Costs."

In April 1989, the NRC granted LILCO a license to operate Shoreham at full capacity, despite the existence of the above Settlement which would transfer Shoreham out of LILCO's control. LILCO also lacked the emergency evacuation plan NRC required to obtain such a license because Suffolk County

had withdrawn its participation in LILCO's proposed plan in 1983. Instead, Federal officials had tested LILCO's evacuation plan in 1986 and approved it without local participation.

In accordance with the terms of the final Settlement signed in 1989, LILCO management signed a reimbursement agreement with LIPA in January 1990. The terms of this agreement required LILCO to reimburse LIPA for all Costs Attributable to Shoreham (CATS), including the decommissioning, maintenance, technical services, project management services, and the on going ownership and possession of Shoreham. These costs were required to be audited in accordance with the Site Cooperation and Reimbursement Agreement. (A report was issued in October 1994 for the period up to December 1991. LIPA officials indicated in their comments that the audit for the next period has not yet begun.)

In June 1990, LIPA and LILCO jointly requested the NRC to transfer LILCO's Shoreham operating license to LIPA. In December 1990, LIPA submitted to the NRC a proposed decommissioning plan with a budget of \$186 million and a time frame of 27 months. The NRC granted the license transfer request in February 1992 and approved LIPA's decommissioning plan in June 1992.

LIPA then embarked on the first decommissioning of a commercial nuclear plant ever attempted in the United States. LIPA's decommissioning methodology (DECON) envisioned the property's use without restrictions at the operation's end. In October 1994, LIPA's chairman announced that its final survey confirmed that Shoreham's decommissioning was complete. At a public hearing in December 1994, senior officials of the NRC, after an independent consultant surveyed the site, reached the same determination. In May 1995, the NRC terminated LIPA's operating license, thereby allowing Shoreham to be used without any NRC license restrictions.

Decommissioning costs are reported to be \$181.5 million. Other costs LIPA and LILCO associated with the closure, transferring and decommissioning of this project total about \$965 million, including \$115 million to dispose of contaminated fuel and \$418 million for taxes and payments in lieu of taxes (PILOTs). LIPA officials reported that they sold about \$873,000 in assets through April 1995. Thereafter, they hired a contractor to conduct the liquidation of the plant's remaining salvageable equipment in August 1995.

LIPA has investigated possibilities for a non-nuclear use for the Shoreham site that would result in some benefit to Long Island residents. As discussed later in the section of this report entitled "Disposition of Property," a gas-fired generating plant and a ferry terminus were proposed, as possible uses for the property, but no action has been taken by the Board as yet. At this time, LIPA has neither suggested nor received any other proposals for alternate uses for the plant.

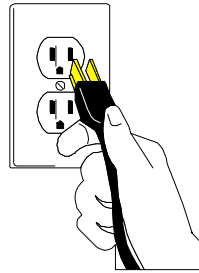
The Shoreham Legacy

In hindsight, LILCO's construction of a nuclear generating plant on Long Island seems to be an example of a financial debacle that could have been avoided. LILCO's dogged determination to finish the project, and its decision to test the plant's operating capability in spite of significant public resistance, appears to be the result of decision-making that was not responsive to customers' concerns. However, to fairly appraise the wisdom of these decisions, it is necessary to understand the context in which they were made. Shoreham's construction and licensing process was very protracted, and the costs of construction and borrowed funds increased dramatically. As Shoreham's construction costs grew and nuclear safety became an international issue, the majority of Long Island residents and local political leaders developed an aversion to building and paying for the facility. LILCO officials claim that delays to comply with changing nuclear regulations and licensing requirements and the lack of cooperation from government leaders in emergency planning made decision-making more difficult and helped to create the financial "white elephant."

Paying the Costs

Regardless of accountability issues, however, the results of decisions and agreements made by LIPA, LILCO, the PSC and the Governor's office are as follows: LILCO ratepayers are paying for a "regulatory asset" valued at \$4.2 billion at the time it was created by the Settlement; as of December 31, 1994, the unamortized balance of this asset was \$3.5 billion. According to the PSC, ratepayers are providing sufficient cash flow to ensure LILCO's financial recovery. LILCO customers are also paying for all LILCO costs associated with decommissioning the plant and owning the property (\$965 million). In addition, LIPA budgeted almost \$69 million for costs associated with ownership and possession of Shoreham for fiscal 1995. LIPA must continue to budget millions for PILOTs and costs associated with ownership in future years. In turn, LILCO will reimburse LIPA for these costs, and pass them on to its customers.

LILCO provided the following schedule to show the financial impact of Shoreham-related costs on ratepayers for the period 1993 - 1995:



<u>Year</u>	<u>Percent of Bill Due to Shoreham</u>	<u>Portion of Average Residential Bill Due to Shoreham</u>	<u>Portion of Average Commercial Bill Due to Shoreham</u>
1993	25%	\$316	\$2,766
1994	32%	\$424	\$3,735
1995*	27%	\$357	\$3,151

* Projected

Needless to say, a significant portion of the average annual utility bill of both residential and commercial customer goes to pay for the decommissioned Shoreham plant.

According to LILCO officials, they experienced management changes as a result of the Shoreham venture. Further, its stockholders absorbed \$1.4 billion in costs that the PSC ruled could not be included in utility rates. Despite these negative impacts, however, LILCO has emerged intact from the Shoreham experience, and has been, to some extent, restored to financial health: some of the company's securities are now rated investment grade.

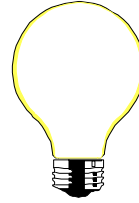
LIPA's Mandate to Reduce Costs

One of the principal reasons LIPA was created was to help relieve the financial burden of paying for LILCO's huge investment in Shoreham and to takeover LILCO. However, ratepayers apparently tended to believe that the takeover was abandoned to rescue LILCO at their expense. From the perspective of LILCO customers, the terms of the Settlement and Rate Moderation Agreement provided only regular rate increases, not economic relief.

Since LILCO customers are still paying for most of Shoreham's costs, their unhappiness with the Shoreham solution is not surprising. According to National Association of the Regulatory Utilities Commissioners, as reported in June 1995, the rates LILCO customers paid in the Summer of 1994 were the highest in the nation, as illustrated in the following chart:

Utility

Average Cost Per
Kilowatt Hour



LILCO	18.0 cents*
Citizen Utilities of Hawaii	16.8 cents
Hawaii Electric Light Company	16.8 cents
Consolidated Edison of New York	15.9 cents
Nantucket Electric	15.2 cents
Orange and Rockland Utilities	14.8 cents
Commonwealth Edison	14.2 cents
Public Service Comp. of New Hampshire	14.2 cents
PECO Energy	13.9 cents
United Illuminating Company	13.5 cents

*** LILCO's average system rates**

It should be noted that the reported average cost of electricity nationwide was 9.3 cents per kilowatt hour. Therefore, LILCO's rate during this period was almost double the national average.

The Proposed Takeover of LILCO

Created with a mandate to advocate for the interests of Long Island ratepayers, LIPA has broad statutory powers to respond to the "threat to the economic well-being, health and safety of the residents, commerce and industry" on Long Island posed by LILCO's huge investment in the Shoreham plant. LIPA is empowered to acquire LILCO, if it determines that the rates would be equal to or less than the rates which would result if LILCO were to continue in

operation on Long Island. Although certain feasibility studies projected that LIPA's acquisition of LILCO would result in lower rates on Long Island, no takeover has occurred.

The Act states that LIPA can negotiate the purchase of LILCO stock or assets and tender an offer for LILCO stock. LIPA is authorized to "exercise the power of eminent domain" in acquiring LILCO, and to initiate a takeover if it is determined that a publicly owned power system would reduce electricity rate increases on Long Island. Several studies performed prior to the effective date of the Settlement Agreement (June 1988) indicated that a takeover would save money for ratepayers; another study done by LILCO, concluded it would not. A subsequent December 1994 study also determined that a LIPA takeover would benefit ratepayers.

The Sawhill Panel Report, a study conducted in June 1986, concluded that, under certain conditions, a takeover could reduce electricity costs by between 7 and 9 percent, and stated that an acquisition could save ratepayers about \$3 billion over a 15-year period. In 1987, LILCO released its own study which concluded that electric rates would actually average about six percent higher should a takeover occur. To resolve the issue of whether savings would result from a takeover and to address what LIPA viewed as deficiencies in LILCO's study, LIPA hired a research firm to perform a rate study. In this March 1988 study, the researchers projected the comparative revenue requirements of LIPA and LILCO as the utility's operator over a 15-year period, and concluded that savings could reasonably be expected if LIPA were to acquire LILCO.

To determine why a takeover has not materialized, we consulted with LIPA and PSC officials. According to LIPA officials, they did not devote much time to consideration of a LILCO acquisition until May 1995 because they were occupied with the demanding task of decommissioning the plant. Further, they noted that LILCO had rejected three LIPA offers (\$8.75, \$10 and \$12 per share, as stated earlier). LIPA would have to resort to either a hostile takeover (such as acquiring LILCO stock through a proxy battle for stockholders' support) or eminent domain proceedings (acquiring the property through condemnation) would be very expensive and time consuming.

In testimony at PSC hearings in July 1988, Department of Public Service (Department) analysts argued that the greatest benefit would be achieved by opting for the Settlement, and LILCO's restoration to financial health, rather than by the takeover and operation of LILCO as a public utility. The PSC signed the Settlement February 1989. PSC analysts stated that a LIPA takeover would involve risks that would likely offset any savings for ratepayers. Examples of these financial risks identified by the analysts at that time included the following:

-
- ! The studies that projected takeover savings calculated those savings based on a relatively low price per share. The higher the price, the lower the savings achieved. No one knows the price LIPA would eventually pay. LILCO contended, however, that the price per share (within reason) has relatively little impact on the costs of any buy out proposal.
 - ! LILCO resistance to a takeover might mean that LIPA must engage in a proxy battle, which could drive up the per share price, or condemn LILCO's assets, which could take years to accomplish.
 - ! In acquiring LILCO, LIPA could be liable for payment of almost \$1 billion in deferred tax benefits that may be subject to recapture by the Internal Revenue Service.
 - ! The issuance of at least \$8 billion in tax exempt bonds would decrease Federal tax revenues; further, a tax exempt issuance of this size might increase the borrowing costs of New York State and its municipalities.

These arguments outlining a takeover's riskiness and the PSC's endorsement of the Settlement have not ended speculation that a takeover could still happen, or discouraged LIPA from making additional proposals. In October 1994, LIPA made a proposal to negotiate a purchase of the company's common stock at \$21.50 per share. Governor Cuomo announced that he supported a LILCO takeover at this price to reduce utility costs on Long Island. However, Governor Pataki, who succeeded Governor Cuomo as of January 1, 1995, was critical of this buy out plan.

In December 1994, LIPA had completed a study which showed that takeover activities for a buy out at this price would cost at least \$9.2 billion. According to the study, this offer would produce an initial rate decrease of \$186 million for at least four years and would lower LILCO's rates by about 2 percent for the next 30 years. As a result of this study, in June 1995, LIPA made yet another offer for LILCO's stock at \$17.50 per share. LILCO responded to LIPA's bid and stated that there were too many uncertainties in this proposal to warrant further consideration.

LIPA's Chairman conceded that a takeover would be very difficult to achieve, but is still not impossible. A new Board of Trustees was appointed at LIPA as of September 1, 1995. The new Board, acting with other State policymakers, is assessing the potential benefits of a LILCO takeover as a means of reducing the high electric rates on Long Island. Any consideration of a future buy out initiative must first find an acceptable way of minimizing the financial burden posed by Shoreham-related debt, and do it within the context of the anticipated restructuring of the electric utility industry in New York State. Further, consideration of a prospective takeover must involve

confirming the accuracy of the estimated savings from LIPA's most recent proposal. Such consideration would also demand that the benefits of rate reductions for Long Island residents and businesses be weighed against a buy out's effects on taxpayers and impact on State borrowing.

The Rate Moderation Agreement

In March 1989, LILCO and the PSC entered into a Rate Moderation Agreement (RAM) whose purpose was to return LILCO to "investment grade financial condition as an investor-owned electric and gas corporation..." The agreement stated that the PSC would determine a reasonable utility rate which would both restore LILCO's financial integrity and minimize the effects of the restoration on LILCO ratepayers. In testimony before the PSC in March 1989, Department analysts stated that the Rate Moderation Agreement constrains future rate increases as much as reasonably possible, consistent with the goal of LILCO's financial recovery. They also stated that a healthier LILCO would likely result in lower utility bills for the consuming public.

The agreement established that the 5.4 percent annual increase (granted in the terms of the Settlement) would be maintained and be effective February 18, 1989. The terms also called for additional annual rate increases of 5 percent, effective December 1, 1989, and 5 percent effective December 1, 1990. The RMA also stated that there may be annual increases from between 4.5 and 5 percent between 1992 and the end of the 10-year recovery period established by the agreement. In June 1995, the PSC reported that LILCO had been allowed subsequent electric rate increases of 4.15 percent, 4.10 percent and 4 percent, effective December 1, 1991, 1992 and 1993, respectively. The PSC notes that the most recent rate proceeding resulted in a zero additional increase effective December 1, 1994. LILCO noted that it had also proposed requesting a zero additional increase in December 1995.

The fact that the most recent rate increases have been lower than originally anticipated has not provided much consolation to Long Island residents. LILCO management had made the decisions to incur Shoreham's billions of dollars in costs; LILCO customers did not participate in these decisions and never benefited from the facility. From the ratepayers' point of view, the RMA simply instituted a predictable pattern of rate increases that made them unwilling participants in a plan to finance LILCO's bailout.

LILCO's Share of Shoreham's Costs

Long Islanders have characterized the Settlement as a "sweetheart deal" for LILCO. LILCO was on the brink of bankruptcy as a result of borrowing billions to build a facility that would never be used. The Settlement and the RMA engineered LILCO's rescue and restoration to good health. Some Long Island residents believe that, while they made - and continue to make - LILCO's rescue possible, LILCO management was not held sufficiently

accountable for Shoreham-related decisions, and its stockholders did not pay their fair share of the costs of the Shoreham fiasco.

However, LILCO officials stated that Shoreham and its problems provoked a major "shake-up" in LILCO management. In addition, LILCO officials noted that stockholders received no dividends for five years, which they estimate to be worth about \$1 billion. Stockholders also had to absorb \$1.4 billion in Shoreham-related costs. In December 1985, the PSC determined that, because these costs resulted from imprudent management mistakes, LILCO could not pass them on to ratepayers. According to the PSC, whose auditors continually monitor LILCO's financial condition, these costs were borne by stockholders, not customers.

Nonetheless, LILCO has been able to defer millions of dollars in Federal tax. According to Department calculations, the \$1.4 billion in PSC-disallowed costs have a tax basis of over \$780 million, which is deductible for tax purposes. This tax benefit accrued to LILCO stockholders. However, LILCO officials point out that this benefit is similar to the depreciation allowance the company would have been entitled to had the plant operated.

Disposition of Property

One of the principal tasks for which LIPA was created was to reduce the high energy rates on Long Island. Other tasks were related to decommissioning the Shoreham facility and converting the plant to a non-nuclear use that would benefit local residents. LIPA has succeeded in completing the decommissioning project. Also, LIPA officials believe they have succeeded in their role of ratepayers advocates. They claimed to have been a major participant on the PSC rate setting hearing and are at least partly responsible for moderating LILCO's rate increases.

From the time the Plan was approved, LIPA succeeded in managing Shoreham's decommissioning within the budgeted cost and time frame for the project. LIPA hired NYPA and various third-party contractors to decontaminate the plant, dispose of radioactive fuel and dismantle the nuclear reactor. This was a significant achievement, in light of the lack of precedents for such an undertaking. The task was accomplished on time, and at a cost reported by LIPA to be \$181.5 million.

However, LIPA has not been successful in implementing a suitable non-nuclear use for the decommissioned plant. Only two uses have been proposed for the site, but no action has been taken to date. LIPA is now maintaining the property and paying PILOTs on it.

The first concept proposed for Shoreham was its conversion to a 413 MW natural gas-fired power plant to be ready for use in 1996. The consultant LIPA hired to study this option found that such a conversion would be feasible, practical, economical and environmentally compatible. Total costs of

restructuring the facility were estimated to be in excess of \$215 million. The study projected that the conversion would save LILCO ratepayers between \$247 million and \$799 million between 1991 and 2013. LIPA requested proposals for the project in January 1992 and they were submitted in July 1992. However, LILCO officials contended that additional energy capacity is not expected to be needed on Long Island until 2005 at the earliest, and that building a new plant, rather than converting Shoreham, would be more cost-efficient. The State Energy Office confirmed LILCO's assessment that additional energy was not needed until 2005. LIPA decided to delay this conversion plan. Under current regulation, LIPA would need LILCO's cooperation to build a new plant and tie it into LILCO's existing network.

The second concept involved the establishment of a high-speed ferry between Shoreham and New Haven, Connecticut. Studies that had been conducted by other agencies concluded that such a service would benefit Long Island's economy. The Departments of Transportation of New York and Connecticut sought proposals for this project in April 1993. In February 1995, the Suffolk County Budget Review Office rejected this proposal because it concluded that it would take more than eight years for the service to generate a profit.

LIPA is currently maintaining Shoreham in an inoperative state, and is required to be reimbursed by LILCO for the costs it incurs in doing so. As noted earlier in this report, costs associated with ownership and possession of the now defunct Shoreham facility (site and ownership management, LIPA headquarters, et al.) have been about \$9 million annually. PILOTs in 1995 are budgeted at \$61.3 million. A potential offset to these costs is LILCO's recovery, pursuant to a court judgment, of property tax overassessment totaling \$78 million in the years 1976 through 1983. LILCO is also protesting tax assessments levied in 1984 through the present, which is estimated to be worth hundreds of millions of dollars.

Alternatives to converting the site or maintaining it idle are demolishing the plant or returning it to LILCO. The Washington Public Power Supply System has scheduled the demolition of four full-size nuclear plants in that State, and plans to spend in excess of \$200 million to complete the job. LIPA and LILCO officials dismiss this option as unnecessary and prohibitively expensive. Finally, LILCO does not want or need the plant and/or the property. LILCO officials state that, should the demand for energy increase in the future, it would be more cost effective to build an entirely new facility.

LIPA and Its Future Role

LIPA is essentially a product of the Shoreham debacle. It was created to accomplish three principal tasks and has successfully completed one: decommissioning the Shoreham facility. Since it did not take over LILCO, LIPA did not reduce energy costs on Long Island. Further, it has not been able to obtain consensus on a suitable use for the idle plant to generate an economic benefit for local residents. However, regardless of LIPA's past inability to bring down LILCO's utility rates, LIPA contends that it has at least succeeded in moderating the rate increases charged to LILCO customers, and its activities indicate that it has made efforts to serve as a ratepayers' advocate. Moreover, LIPA is the only entity created to reduce energy costs on Long Island.

The Act that established LIPA stated that all appropriations made to LIPA were to be treated as advances of State funds, to be repaid without interest from the issuance of bonds or excess revenues. However, LIPA did not take over LILCO, so it issued no bonds and earned no revenues from utility operations. Since the Legislature did not appropriate any funds to support LIPA's operations in the 1995-96 budget, LIPA is currently using the interest it has earned on investment of State appropriations for operating funds. As a result, LIPA is not financially able to repay either the advances of the State funding totaling about \$15.3 million, or the \$671,000 in interest revenues.

It is uncertain what kind of role LIPA will have in Long Island's energy picture. While additional funds have yet to be appropriated for LIPA's operations, recent legislative action has provided for a reconstituted LIPA Board as of September 1, 1995. The Governor appointed a Chairman and eight other members of this new Board and Legislative leaders appointed the remaining six members. After the new Board was installed, Governor Pataki called for the dissolution of LILCO and a reduction in electric rates, and assigned the new Board the task of determining the best way of achieving these tasks. The Governor estimated that, by mid-December 1995, the new LIPA Board will propose a workable plan to bring down the electric rates of LILCO customers. LILCO ratepayers have been awaiting such a plan since LIPA was created in 1987.

In developing the most prudent and equitable means of dealing with Shoreham-related costs, State policymakers should carefully weigh the impacts of any decision on the public (both Long Island ratepayers and all taxpayers statewide), and give consideration to all planning options. In deciding how best to serve diverse interests, policymakers may determine that an entity other than LIPA should advocate for the interests of LILCO ratepayers. For example, PSC investigates the propriety and equity of proposed increases in rates, and the Consumer Protection Board also monitors utility rate issues. It also appears that, in any serious renewal of a takeover effort, NYPA could perform functions that the Act assigned to LIPA to accomplish this objective, given

appropriate Legislative action. Had earlier takeover efforts been successful, LIPA would likely have contracted with another entity to manage utility operations.

Currently, LIPA is the only public entity that can legally take over LILCO, in accordance with the authority provided by the Act. The Internal Revenue Code was also amended to allow LIPA to issue tax free bonds without having to include the amount of the bonds within the bond issuance total allowed by law. If it is determined that an entity other than LIPA should take over LILCO, both of these laws would require amendment.

It is healthy for government to examine, on a regular basis, what services are being provided and how effective and efficient those services are. Budget requirements, changes in the political climate and changes in the public's expectations of government operations have resulted in adjustments in the way government works, and will likely continue to do so. However, adjustments must be made responsibly, so that new remedies do not create greater long-term financial problems. State policymakers should review Shoreham's history and identify the goals to be achieved in dealing with these longstanding costs and rate issues.

Items for Consideration

1. Given the existing regulatory structure within which New York State utilities operate, electric rates on Long Island will remain among the highest in the nation unless an acceptable way is found to minimize the long-term financial burden associated with Shoreham-related debt. Policymakers must determine the most prudent and equitable manner of accomplishing this reduction. Any proposed cost reduction should include a specific plan to achieve this goal, set a target date for its accomplishment and indicate the relevant costs to be borne by all parties.
2. Consideration should be given to assigning LIPA's advocacy role to another entity, such as the PSC or the Consumer Protection Board. Both entities have a outstanding tradition of looking after the interests of utility consumers. Should this occur, there would be no further need to maintain LIPA to deal exclusively with the interests of Long Island residents.
3. Renewed attention should be given to finding a useful purpose for the now defunct Shoreham facility, which continues to be a financial drain on LILCO and its customers.

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