



## V.C. SUMMER IS A SYMPTOM OF A LARGER PROBLEM

In 2008 and together with nuclear construction company Westinghouse, South Carolina electric utilities South Carolina Electric & Gas (SCE&G) and Santee Cooper announced that they would begin building two new nuclear reactors at the V.C. Summer plant in Jenkinsville, South Carolina. The trio of companies estimated that the project would cost \$9.8 billion and that both units would be operational by no later than 2018.

However, it quickly became apparent that this was a bad deal for South Carolinians, as the new V.C. Summer construction was marred by delays and massive cost overruns. In 2017, Westinghouse filed Chapter 11 bankruptcy and with the project no longer viable, SCE&G and Santee Cooper abandoned their plans altogether later that year. This left ratepayers holding much of the tab for the incomplete reactors.

The aftermath of the V.C. Summer debacle has since sparked considerable debate among regulators, legislators and ratepayers, all of whom have sought both scapegoats and answers about what went wrong. However, V.C. Summer is simply one symptom of a more fundamental problem: South Carolina's regulatory framework itself encourages such behavior in electricity markets. Until this is addressed, South Carolinians can expect more imprudent behavior from regulated utilities.

### THE CURRENT SYSTEM

As in much of the country, electric utilities in South Carolina enjoy monopoly status that stems from a bygone era. Widespread use of electricity first emerged during the Progressive Era, when there was a growing belief that competition was harmful and that government could offer superior results in many areas. Electricity was thus considered a “natural monopoly” that would be provided most efficiently by a single company or organization per region. As a result, utilities were given protected monopoly status and in exchange, were subject to heavy regulation on rates and services.

The monopoly model was, and still is, fraught with flaws. Under this system, customers have no choice of electric providers. Instead, they are forced to choose the one provider allowed to operate in their particular geographical region. Because of this, electric companies are not incentivized to provide exemplary customer service or lower prices. Electric companies also have less incentive to act with prudence. After all, when poor business decisions are made, ratepayers cannot switch electricity providers.

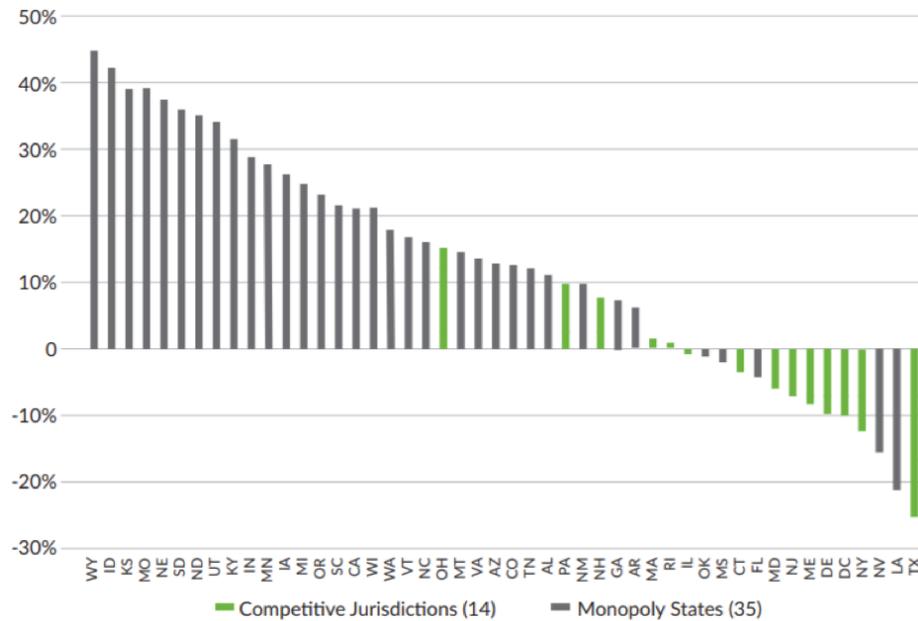
### ELECTRICITY RATE-MAKING

Another problematic component of the regulated monopoly model has to do with the setting of electric rates. For most businesses, keeping costs low is key to a sustainable business model. Businesses that spend unnecessarily eat into their own profits and endanger their long-term sustainability. With electric utilities, however, the opposite can be true. The rates that a utility is allowed to charge are a function of its costs—the more money a utility spends, the more it is permitted to recoup from ratepayers. Therefore, utilities have an incentive to invest in large, costly projects even if they would not make sense in an open market.

In addition to recovering costs, utilities are typically allowed to recover an additional amount from ratepayers, representing a “rate of return” on their investments. This is usually expressed as a percentage of the utility's costs, such that higher costs allow higher profits. In most scenarios, state regulators approve rates that guarantee a seven to nine percent profit on such endeavors. In South Carolina, the rate of guaranteed profit for utilities can be even higher. SCE&G, for example, has an approved rate of return on equity of 10.25 percent. Once approved, captive ratepayers have little choice but to pay the increased prices.

What's more, South Carolina approved a system of advanced-cost recovery so that utilities can charge captive ratepayers for any excessive and unforeseen costs that might occur in advance of finalizing new

**FIGURE I: STATE RANKING—ALL SECTOR PRICE PERCENTAGE CHANGE 2008-2016**



SOURCE: Philip R. O'Connor, "Restructuring Recharged," Retail Energy Supply Association, April 2017. [https://www.resausa.org/sites/default/files/RESA\\_Restructuring\\_Recharged\\_White%20Paper\\_0.pdf](https://www.resausa.org/sites/default/files/RESA_Restructuring_Recharged_White%20Paper_0.pdf).

construction. In V.C. Summer’s case, there were massive cost overruns, but this protection further insulated the utilities from the consequences of their poor decisions.

**SOLUTIONS**

South Carolinians are understandably searching for answers in the aftermath of the V.C. Summer debacle, but the fault lies, in large part, with the state’s electricity regulatory regime. First, since electricity providers benefit from state-backed monopoly status, they can act recklessly without fear of losing their customers. Second, because they are able to recoup cost overruns in advance and enjoy the benefits of cost recovery, the utilities are shielded from negative consequences and are, in fact, encouraged to build as much as possible to increase their profits.

The solution to these problems is to use market discipline to encourage sensible business behavior. The state should permit more competition in electricity markets. If providers are forced to compete for customer loyalty, utilities will be dissuaded from undertaking risky endeavors.

While monopoly regulation may have been merited in the past, recent decades have shown that the generation of electricity is not a natural monopoly. Over a dozen states currently allow some form of competition in their electricity system. This competition has been a great boon for consumers, as most states with competition have seen falling electricity prices, while electric rates in monopoly states have tended to grow. The ability of consumers to choose their own electric provider has disciplined utilities to make more prudent decisions, and has led to greater innovation overall.

**CONTACT US**

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