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Monopoly regulation, discontinuity & stranded assets

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Abstract
For regulated electricity utilities, if trend-load growth enters a state of terminal decline through disruptive competition and costs are unable to contract at a similar rate, the regulatory outcomes that follow produce strikingly different results to an equivalent episode in a competitive market, where profits fall and assets are written-off. Under economic regulation, prices rise to offset volumetric losses and in the presence of disruptive competition, a destructive price spiral can ensue. In these circumstances, some component of the regulated utility’s assets meet the definition of ‘stranded’. Failure to deal with stranded assets will eventually, and needlessly, damage shareholders, consumers and welfare. However, the ‘regulatory compact’ makes this an especially complex area of economics. Zero recovery of stranded monopoly assets is not credible policy. A normative analysis of economics and law suggests full recovery is not credible either. In this article, asset stranding experience from the US is reviewed and a series of policy principles are established; viz. asset stranding is a case-by-case proposition involving recovery via non-bypassable pricing mechanisms, quantified and packaged as a partial Return of Capital, possibly financed by Transition Bonds on a time-limited basis. Financial risk tolerances of the utility and the stability of post-stranding consumer tariffs are important parameters that should guide the policy approach to asset stranding. But ultimately, asset stranding is a policy choice, not an analytical determination.

Keywords: Electricity Utilities, Stranded Assets.
JEL Codes: D4, L5, L9 and Q4.

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