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# Recovery of Electric Utility Losses from Abandoned Construction Projects

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## RECOVERY OF ELECTRIC UTILITY LOSSES FROM ABANDONED CONSTRUCTION PROJECTS

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### I. INTRODUCTION

What a difference ten years make. In the 1970 *National Power Survey*, produced by the then Federal Power Commission, we find the stern warning:

Mounting demand, sharply rising costs, and changing social values have combined to place unusual stress on the U.S. electric power industry. . . . We foresee recurrent and spreading power shortage unless positive steps are taken, and taken soon, to remedy conditions which are slowing the orderly development of essential power supplies.<sup>1</sup>

Electric utilities like Northern States Power Company (NSP) had been looking at annual increases in electric system demand of seven to nine percent per year. This growth rate would require more than doubling system capacity in a decade.

In October 1981, Senator Edward Kennedy's office issued a

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The author wishes to acknowledge the assistance of David A. Lawrence and Joanne E. Hinderaker of the NSP law department in the preparation of this paper.

1. FEDERAL POWER COMMISSION, THE 1970 NATIONAL POWER SURVEY, Part 1 I-1-1 (1971), quoted in *Trends and Topics: Recouping Abandoned Construction Losses*, PUB. UTIL. FORT., Feb. 26, 1981, at 60.

press release that announced, "Power Plant Cancellations Saved Customers Billions." The statement continued:

I am today releasing an analysis of the capital cost savings to American consumers that have resulted from the cancellation or the indefinite deferral of previously planned electric power plants. This analysis shows that not building those power plants may have saved consumers tens of millions of dollars in capital costs.<sup>2</sup>

Between these points in time, the United States experienced the Arab oil embargo, double digit inflation, recurring economic recessions, Three Mile Island, and accelerated government control over plant siting and expansion. In addition, a substantial and broadly based effort to cut energy consumption through conservation, load management, and other measures designed to reduce the projected need for new electric plant capacity was initiated. As a result, many projects at various stages of planning and construction have been terminated and abandoned.

In the wake of this change in circumstances, electric utilities and their regulators have had many opportunities to address the accounting and ratemaking issues related to amortizing the investment and cancellation costs of abandoned projects and recovering the expense through rates. In general, utilities have been allowed to account for these costs by assigning the amount of the loss to Account 182 (Extraordinary Property Losses) and to amortize the loss as a charge to income over a reasonable number of years in Account 407 (Amortization of Property Losses).<sup>3</sup>

For ratemaking purposes, utilities have usually been allowed to recover the annual amortization expense from ratepayers as a component of the total cost of service. Utility shareholders have shared in the loss, however, by foregoing a return on the unamortized balance in Account 182. To receive authorization to collect the cost from ratepayers, a utility must establish that it acted prudently in undertaking the project, that the claimed expenditures are reasonable in amount and properly documented, and that it acted prudently in cancelling the project. Whether or not a return is allowed on the unamortized balance often depends on precedent in the jurisdiction involved, particular statutory provisions, the

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2. Reference was made by Senator Kennedy to Library of Congress studies on cancelled electric generating plants.

3. *See* Federal Energy Regulatory Commission Uniform System of Accounts, 18 C.F.R. Ch. 1, Subch. C Part 101 (1982).

regulators' evaluation of the circumstances creating the write-off, the financial health of the utility, and the impact on ratepayers and investors.

These generalizations provide the necessary background for a discussion of the approaches taken to abandoned plant issues by the Federal Energy Regulatory Commission (FERC)<sup>4</sup> and the Minnesota Public Utilities Commission.<sup>5</sup>

## II. FEDERAL ENERGY REGULATORY COMMISSION

An electric utility that is a licensee of a hydroelectric plant under Part I of the Federal Power Act,<sup>6</sup> or a public utility because it sells electric energy for resale and transmits electric energy in interstate commerce under Part II,<sup>7</sup> must keep its books and records as prescribed by the Federal Power Act.<sup>8</sup> FERC accounting is primary. FERC accounts must be used as the official company accounts for accounting and financial reporting purposes.

In *Appalachian Power Co. v. Federal Power Commission*,<sup>9</sup> the court held that FERC, not the particular state commission, has the power to regulate the basic accounts companies under FERC's jurisdiction must use for financial reporting.<sup>10</sup> The court reviewed the history behind this policy and stated:

Noting further how ineffective states have been in their efforts to regulate accounting practices of interstate electric systems, the Federal Trade Commission found that the evils existing in the industry "flourished in spite of such regulation as has existed." The Trade Commission recommended to Congress the enactment of legislation to correct these abuses by the creation of an appropriate federal agency with "power to make and enforce *uniform* accounting \* \* \*." The present Federal Power Act and the Federal Power Commission are the fruit of that investigation.

In unambiguous language section 301(a) of the Act, 16 U.S.C.A. § 825(a), empowers the Commission to require utilities to keep "accounts, records of cost-accounting procedures, correspondence, memoranda, papers, books, and other records as the Commission may by rules and regulations prescribe as

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4. See *infra* notes 6-26 and accompanying text.

5. See *infra* notes 27-42 and accompanying text.

6. 16 U.S.C. §§ 791a-823 (1976).

7. *Id.* §§ 824-824h.

8. *Id.* § 825.

9. 328 F.2d 237 (4th Cir. 1964), *cert. denied*, 379 U.S. 829 (1964).

10. *Id.* at 246.

necessary or appropriate for purposes of the administration of this Act, \* \* \*.” The burden of justifying any accounting entry is placed squarely on the “person making, authorizing, or requiring such entry \* \* \*.”<sup>11</sup>

As to the potential of federal-state conflicts, the court held:

The Company urges that a proviso clause in section 301(a) negatives the Commission’s jurisdiction over the Company’s reporting of financial data to the general public. We find no support for this contention. The clause referred to recites:

“That nothing in this Act shall relieve any public utility from keeping any accounts, memoranda, or records which such public utility may be required to keep by or under authority of the laws of any State.”

In numerous cases it has been held that the Commission’s accounting is not subordinated if it comes into conflict with state regulatory requirements. It should be noted that the proviso is a prohibition running to public utilities; not to the Commission: “[N]othing in this Act shall relieve any *public utility* from keeping any accounts \* \* \* required \* \* \* by \* \* \* the laws of any state.” It was embodied in section 301 to insure that state commissions shall not be precluded from prescribing accounting procedures necessary for their regulation. But, as pointed out by Justice Roberts, speaking for a unanimous Supreme Court in the Northwestern Electric case, “We are not here concerned with what the regulatory authorities of [the state] may or may not demand or permit. Whatever that action may be, it is subordinate to Congress’ appropriate exercise of the commerce power.”

Who then is to determine what shall be a regulated utility’s basic records and how these records are to be reflected in public financial reports?

It would appear to be a truism that a corporation can have only one set of basic corporate books which reflect its actual financial condition . . . . Of course, for certain purposes, such as state rate determinations, it may be deemed advisable by the state regulatory commissions to have accounts stated in a special way. The Federal Power Commission’s order does not preclude this as long as differing state accounts are subordinated to and do not obscure the presentation of the accounts prescribed by the Commission.<sup>12</sup>

The pre-emption of state accounting exists even if the utility is not

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11. *Id.* at 247 (footnotes omitted).

12. *Id.* at 247-49 (citations and footnotes omitted).

subject to FERC rate regulation,<sup>13</sup> and even where inconsistent accounting is *specifically required* in the utility's major retail jurisdiction.<sup>14</sup>

Fortunately, there is no real accounting conflict in Minnesota. The Minnesota Public Utilities Act provides that the commission shall establish a system of accounts, but:

A public utility which maintains its accounts in accordance with the system of accounts prescribed by a federal agency or authority shall be deemed to be in compliance with the system of accounts prescribed by the commission. Where optional accounting is prescribed by a federal agency or authority, the commission may prescribe which option is to be followed.<sup>15</sup>

Therefore, the Uniform System of Accounts and the FERC approved amortization plan are controlling for book and financial reporting purposes in Minnesota. This does not mean that the issue may not be litigated before FERC or the Minnesota commission for ratemaking purposes. In fact, if a utility's major retail rate jurisdiction were to disallow recovery of the amortization of the extraordinary property loss in rates, it is likely that the FERC accounting approval would be withdrawn. This would occur because accounting is intended to reflect the true operations of the company. This includes ratemaking treatment. It is often said that accounting follows ratemaking.

FERC has established ratemaking precedent in several recent cases. In *New England Power Co.*,<sup>16</sup> FERC found the company's abandonment of its proposed oil fired Salem Harbor Unit 5 prudent and that the \$13 million in costs should be recovered in rates over a five year period. FERC, however, denied the company a return on the unamortized balance. The latter determination was made on the basis that the investment was not in property used and useful in the public service.<sup>17</sup> The balancing of investor and ratepayer interests was also discussed.<sup>18</sup>

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13. *See Louisville Gas & Elec. Co. v. Federal Power Comm'n*, 129 F.2d 126, 132-33 (6th Cir. 1942), *cert. denied*, 318 U.S. 761, *reh'g denied*, 318 U.S. 800 (1943).

14. *See Arkansas Power & Light Co. v. Federal Power Comm'n*, 185 F.2d 751 (D.C. Cir. 1950), *cert. denied*, 341 U.S. 909 (1951).

15. MINN. STAT. § 216B.10 (1982). Obtaining FERC approval of an amortization plan constitutes mandatory, not optional, accounting.

16. Op. No. 49, Docket Nos. ER76-304, ER76-317, ER76-498, [1979-1982 Transfer Binder] UTIL. L. REP. (CCH) ¶ 12,210 (F.E.R.C. July 19, 1979).

17. *Id.*

18. *Id.*

In its decision on NSP's Tyrone Project,<sup>19</sup> FERC specifically found that NSP had acted prudently in commencing and later cancelling an 1100 megawatt nuclear unit planned for construction at Durand, Wisconsin. The commission extended the five year proposed amortization period for the \$75 million<sup>20</sup> loss to ten years but otherwise followed NSP's proposed treatment and the general approach to abandonments discussed earlier.<sup>21</sup> FERC rejected contentions by Minnesota, North Dakota, and South Dakota that NSP's Wisconsin customers should bear all of the costs at issue because the Wisconsin Public Service Commission's decision to deny the permit was parochial and considered only Wisconsin needs.<sup>22</sup> Also rejected were intervenor contentions that the tax loss be deducted from the rate base and that NSP not be allowed to recover the equity component of the Allowance for Funds Used During Construction (AFUDC) booked on the project. FERC has been upheld by the Eighth Circuit Court of Appeals.<sup>23</sup> Other FERC cases that considered pre-construction abandonment losses include *Virginia Electric & Power Co.*,<sup>24</sup> *Louisiana Power & Light Co.*,<sup>25</sup> and *Southern California Edison Co.*<sup>26</sup>

At this date, FERC appears to have established that gross costs of abandoned projects, including reasonable estimates of vendor cancellation charges, may be recovered in rates. No return is allowed on the unamortized balance. The term of years selected for amortization depends upon the magnitude of the loss and the impact on ratepayers. In general, the longer the term selected, the greater the burden borne by shareholders. The term has typically been in the three to ten year range, much shorter than the expected life of a cancelled replacement project.

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19. Northern States Power Co., Op. No. 134, Docket No. ER79-616, [1979-1982 Transfer Binder] UTIL. L. REP. (CCH) ¶ 12,516 (F.E.R.C. Dec. 3, 1981).

20. Reduced to \$67.1 million through actual vendor settlements.

21. See *supra* note 3 and accompanying text.

22. Northern States Power Co., Op. No. 134, Docket No. ER79-616, [1979-1982 Transfer Binder] UTIL. L. REP. (CCH) ¶ 12,516 (F.E.R.C. Dec. 3, 1981).

23. South Dakota Pub. Util. Comm'n v. Federal Energy Regulatory Comm'n, 690 F.2d 674 (8th Cir. 1982).

24. Op. No. 118, Docket No. ER78-522, [1979-1982 Transfer Binder] UTIL. L. REP. (CCH) ¶ 12,432 (F.E.R.C. July 30, 1981).

25. Op. No. 104, Docket No. ER77-533, [1979-1982 Transfer Binder] UTIL. L. REP. (CCH) ¶ 12,392 (F.E.R.C. Feb. 12, 1980).

26. Op. No. 62, Docket No. ER76-205, [1979-1982 Transfer Binder] UTIL. L. REP. (CCH) ¶ 12,233 (F.E.R.C. Aug. 22, 1979).

### III. MINNESOTA PUBLIC UTILITIES COMMISSION

In the 1975 NSP rate case,<sup>27</sup> the first electric rate case under the Minnesota commission's jurisdiction, the commission accepted, without discussion, the company's proposed inclusion in the cost of service of the annual expense related to the abandoned Pathfinder nuclear plant. The same treatment was discussed by the commission and afforded to the Monticello nuclear plant fuel rod replacement expense.<sup>28</sup>

In the next NSP rate case,<sup>29</sup> the commission partially reversed itself when addressing the Pathfinder determination and the abandoned Sibley County plant site. Pathfinder was a small pilot nuclear plant built in South Dakota. It never operated properly and was abandoned. Sibley was an alternate site for the Sherco plants and was also abandoned. The commission allowed recovery of the annual expense but removed the unamortized balance from rate base on a used and useful rationale:

By allowing the amortization, the risk of loss associated with the abandonment is spread between ratepayers and the Company's shareholders.

The Commission finds that this treatment of unamortized investments provides a reasonable balance which should be sufficient to assure that research and development projects are continued in the future.<sup>30</sup>

Another Minnesota utility, Minnesota Power and Light Company (MP&L), experienced problems with the design and operation of a wet scrubber retrofit<sup>31</sup> for the Clay-Boswell plant. In *Minnesota Power & Light Co.*,<sup>32</sup> MP&L had included the annual expense in its costs to be currently recovered and \$2.6 million of unamortized loss in rate base. The commission found imprudence, which it called "serious mistakes or error," and a conflict of interest arising from the scrubber supplier's position on MP&L's board of directors.<sup>33</sup> Since MP&L was not allowed a return on the unamortized balance, the deferred income tax benefit the company

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27. Northern States Power Co., 11 P.U.R.4th 385 (Minn. P.S.C. 1975).

28. *Id.* at 393.

29. Northern States Power Co., Docket No. ER-002/GR-76-934 (Minn. P.S.C. Mar. 2, 1977).

30. *Id.* at 10.

31. In order to meet air quality standards, it was necessary for MP&L to redesign and install sulfur removal equipment to an existing plant.

32. Docket No. E-015/GR-76-408 (Minn. P.S.C. Dec. 18, 1976).

33. *Id.* at 21-22.

had deducted from rate base as non-investor supplied capital was returned to the shareholder.

NSP's Tyrone nuclear plant amortization comes before the Minnesota commission and the courts as a question of federal pre-emption rather than as an analysis of the merits and rate treatment of an abandonment loss. Therefore, discussion of Tyrone will be brief.

In the 1981 NSP rate case,<sup>34</sup> the Minnesota commission rejected NSP's claim that the monthly billings from NSP's Wisconsin subsidiary to NSP(MN), pursuant to the FERC approved Inter-Company Coordinating Agreement, be accepted as a reasonable operating expense for purchased power. NSP asserted that a state commission's review and modification of an expense determined by FERC to be just and reasonable was pre-empted by federal regulation and, therefore, not permitted.<sup>35</sup> The commission recognized that it had litigated the issue before FERC as an intervenor. It held, however, that there is no federal pre-emption.<sup>36</sup> The commission stated that because "the Wisconsin PSC acted in a parochial fashion," the cancellation was of no benefit to Minnesota customers and should not form a basis for charges to Minnesota customers no matter how presented by the company. That decision is currently pending before the Minnesota Supreme Court.<sup>37</sup>

In the same decision,<sup>38</sup> the Minnesota commission applied its normal rule and allowed recovery of the \$800,000 representing the last seven months of a three year amortization related to the abandonment of NSP's proposed Sherco 4 generating plant. It found that Sherco 4 was prudently commenced and prudently abandoned.<sup>39</sup> Administratively, since the amortization terminated during the test year, the expense was recovered during the interim period and final rates were decreased by the appropriate amount.

In this writer's opinion, the Minnesota commission precedent is consistent with the prevailing general rule for amortization of pre-construction abandonment losses. The utility must prove pru-

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34. Northern States Power Co., 42 P.U.R.4th 339 (Minn. P.U.C. 1981).

35. The case law supporting this contention is found in *Narragansett v. Burke*, 119 R.I. 559, 381 A.2d 1358 (1977), *cert. denied*, 435 U.S. 972 (1978).

36. 42 P.U.R.4th at 362.

37. The commission was reversed by the Ramsey County District Court. *Northern States Power Co. v. Minnesota Pub. Util. Comm'n*, No. 452088 (Minn. 2d Dist. Ct. Aug. 3, 1982). That matter is now pending in the Minnesota Supreme Court, Docket No. 82-1130, upon appeal by the commission and others.

38. Northern States Power Co., 42 P.U.R.4th 339 (Minn. P.U.C. 1981).

39. *Id.* at 363.

dence in commencing and cancelling the project. If prudence is demonstrated, the commission allows the utility to recover those dollars prudently invested on the customers' behalf. No return, however, is allowed on the unamortized balance during the write-off period.<sup>40</sup> In *Minnesota Power & Light Co.*,<sup>41</sup> the commission found imprudence; in the Tyrone appeal the issue is acceptance or rejection of a purchased power expense under a FERC approved rate, not an analysis of the merits of the abandonment loss. In other extraordinary property loss situations in which the facility was placed in service, prematurely abandoned, and the loss not covered by insurance or as a part of mass property accounts, the commission may allow a return on the unamortized balance.<sup>42</sup>

#### IV. OTHER REGULATORY JURISDICTIONS

State commissions are virtually unanimous that the utility will be allowed to recover money prudently invested in cancelled construction projects. Regulators are split, however, on whether utilities should be allowed a return on the unamortized balance during the term of an amortization.<sup>43</sup>

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40. See *infra* note 33 and accompanying text.

41. Docket No. E-015/GR-76-408 (Minn. P.S.C. Dec. 18, 1976).

42. See *Interstate Power Co.*, Docket No. E-001/GR-78-1065 (Minn. P.S.C. Sept. 27, 1979), at 8-9 (plant explosion); *Northern States Power Co.*, Docket No. E-002/GR-77-611 (Minn. P.S.C. Mar. 20, 1978), at 12-14 (Prairie Island rotors). But see *Wikstrom Tel. Co., Inc.*, Docket No. P-432/GR-81-70 (Minn. P.U.C. Jan. 28, 1981), at 3; *Peoples Natural Gas Co.*, Docket No. G-011/GR-80-850 (Minn. P.U.C. Nov. 25, 1981); *Continental Tel. Co.*, Docket No. P-407/GR-79-500 (Minn. P.U.C. May 9, 1980).

43. Cases and accounting rulings that both allow recovery of the annual amortization expense and provide rate base treatment for the unamortized balance include *Gulf Power Co.*, Docket No. 800001-EU (Fla. P.S.C. Nov. 10, 1980); *Union Elec. Co.*, Docket No. U-558 (Iowa C.C. Nov. 14, 1975); *Gulf States Util. Co.*, Order No. U-14495-B (La. P.S.C. Nov. 17, 1980); *Consolidated Edison Co.*, Case No. 27744 (N.Y. P.S.C. Mar. 12, 1981) (premature abandonment of operating Indian Point No. 1 nuclear reactor); *Carolina Power & Light Co.*, Docket No. E-2, Sub. 366 (N.C. U.C. May 11, 1979); *Northern States Power Co.*, Order No. F-3062 (S.D. P.U.C. Dec. 30, 1976); *Wisconsin Elec. Power Co.*, Docket No. 05-CE-3 (Wis. P.S.C. Feb. 14, 1980) (Haven Nuclear Plant).

Cases and accounting rulings that allow the recovery of the annual amortization expense, but in which either the utility did not request or the regulator denied the recovery of carrying costs on the unamortized balance, include *Alabama Power Co.*, Docket No. 17667 (Ala. P.S.C. July 19, 1979); *Arizona Pub. Serv. Co.*, 38 P.U.R.4th 547 (Ariz. C.C. 1980); *Arizona Pub. Serv. Co.*, Docket No. U-1345, Doc. No. 47535 (Ariz. C.C. Dec. 13, 1976); *San Diego Gas & Elec. Co.*, 31 P.U.R.4th 435 (Cal. P.S.C. 1979); *San Diego Gas & Elec. Co.*, Docket No. 87639 (Cal. P.U.C. 1977); *Southern California Gas Co.*, Order Nos. 81919, 83881, 86794, 87639, 89711, 92497, and 92549 (Cal. P.U.C., 1973-80); *Connecticut Light & Power Co.*, 30 P.U.R.4th 67 (Conn. Div. P.U. 1979); *Potomac Elec. Power Co.*, 29 P.U.R.4th 517 (D.C. P.S.C. 1979); *Georgia Power Co. v. Public Util. Comm'n*, Civil Action No. C-51925 (Ga. P.U.C. Oct. 12, 1979); *Idaho Power Co.*, No. U-1006-116, Order

A notable exception to all this is a recent Ohio Supreme Court decision reversing the Ohio commission's decision allowing Ohio Power Company to recover its amortization expense for some nuclear projects.<sup>44</sup> The court's decision was based on statutory grounds and disallowed any recovery whatsoever.<sup>45</sup>

In *Office of Consumers' Counsel v. Public Utilities Commission*,<sup>46</sup> the Ohio Supreme Court held that, under a recently amended Ohio law, inclusion in rates of the amortization of pre-construction expenditures in four planned nuclear power plants was inconsistent with the ratemaking formula of the Ohio statute.<sup>47</sup> The Ohio commission had provided for a ten year amortization of the \$69.6 million invested in the Davis-Besse Units 2 and 3 and Erie Units 1 and 2.

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No. 12784 (Idaho P.U.C. Nov. 10, 1976); Union Elec. Co., Docket No. 77-0198 (Ill. C.C. Feb. 8, 1978); Union Elec. Co., Order No. 59835 (Ill. C.C. Dec. 10, 1975); Indiana & Michigan Elec. Co., Case No. 35251 (Ind. P.S.C. Sept. 21, 1978); Potomac Elec. Power Co., Case Nos. 7149, 7300, 7384 (Md. P.S.C. 1978-80); Western Massachusetts Elec. Co., D.P.U. 558 (Mass. Dep't P.U. July 31, 1981); Consumers Power Co., Case No. U-4840 (Mich. P.S.C. Apr. 12, 1976); Consumer Power Co., Case No. F-700 (Mich. P.S.C. Feb. 10, 1975); Detroit Edison Co., Case No. U-5108 (Mich. P.S.C. May 27, 1977); Detroit Edison Co., Case No. F-762 (Mich. P.S.C. July 26, 1976); Union Elec. Co., Case No. ER-77-154 (Mo. P.S.C., Jan. 19, 1978); Public Serv. Elec. & Gas Co., Docket No. 794-310, OAL Docket No. PUC 877-79 (N.J. Bd. P.U. Apr. 11, 1980) (stipulation concerning \$329 million write-off of Atlantic Generating Station); Public Serv. Elec. & Gas Co., Docket No. 744-335 (N.J. Bd. P.U. Oct. 31, 1975); Consolidated Edison Co., Case No. 26827 (N.Y. P.S.C. Feb. 17, 1976); Consolidated Edison Co., Case No. 26309 (N.Y. P.S.C. June 6, 1973); New York State Elec. & Gas Co., Order No. 74-12 (N.Y. P.S.C. Apr. 10, 1974); Rochester Gas & Elec. Corp., Case No. 27794, Order No. 81-1 (N.Y. P.S.C. Jan. 6, 1981); Carolina Power & Light Co., Docket No. E-2, Sub. 352 (N.C. U.C. 1979); Virginia Elec. & Power Co., Docket No. E-22, Sub. 224 (N.C. U.C. 1978); Portland Gen. Elec. Co., Order No. 79-055 (Ore. P.U.C. Jan. 25, 1979); Gulf States Util. Co., Docket No. 2677 (Tex. P.U.C. Oct. 29, 1979); Houston Lighting & Power Co., 36 P.U.R.4th 94 (Tex. P.U.C. 1980); Central Vermont Pub. Serv. Corp., Case No. 4320 (Vt. P.S. Bd. Dec. 8, 1978); Virginia Elec. & Power Co., PUC 810025 (Va. P.S.C. Aug. 24, 1981); Virginia Elec. & Power Co., 29 P.U.R.4th 65 (Va. Corp. Comm'n Mar. 19, 1979); Virginia Elec. & Power Co., Case No. 19027 (Va. Corp. Comm'n Feb. 27, 1971) (no rate base treatment requested); Appalachian Power Co., Case No. 9091 (W. Va. P.S.C. May 3, 1978); Virginia Elec. & Power Co., Case No. 79-040-E-42T (W. Va. P.S.C. Feb. 1, 1980); Northern States Power Co., Docket No. CA-5447 (Wis. P.S.C. Feb. 6, 1981) (no rate base treatment requested for Tyrone); Wisconsin Elec. Power Co., Docket No. CA-5491 (Wis. P.S.C. May 2, 1979); Wisconsin Pub. Serv. Corp. v. Public Serv. Comm'n, Case No. 79-CU-317 (Cir. Ct. II Oct. 15, 1979).

44. *Office of Consumers' Counsel v. Public Util. Comm'n*, 67 Ohio St. 2d 153, 423 N.E.2d 820 (1981), *appeal dismissed*, 455 U.S. 914 (1982).

45. *See id.*; OHIO REV. CODE § 4909.15(A) (Page 1981).

46. 67 Ohio St. 2d 153, 423 N.E.2d 820 (1981), *appeal dismissed*, 455 U.S. 914 (1982).

47. *Id.*

The statutory language involved provides that rates be set on “the cost to the utility of rendering the public utility service for the test period.”<sup>48</sup> The court stated that it did not believe the Ohio General Assembly contemplated inclusion of such a loss in test year costs, stating, “It is our opinion that R.C. 4909.15(A)(4) is designed to take into account the normal, recurring expenses incurred by utilities in the course of rendering service to the public for the test period.”<sup>49</sup>

As noted in *Consumers’ Counsel*, the Ohio legislature laid out specific rules for the commission to follow regarding the inclusion of Construction Work in Progress (CWIP) in rate base.<sup>50</sup> Evidently, the court was exposed to legislative and regulatory history which justified its restrictive construction of how abandonment losses are to be treated. The court indicated that appellants characterized the statute as “a carefully crafted statutory scheme,”<sup>51</sup> and emphasized its “uniquely specific” nature.<sup>52</sup> The decision of the Ohio Supreme Court indicates that members of the court were aware of the contrary decisions of the Minnesota commission in this regard, and recognized that the overwhelming weight of authority supported the Ohio commission’s decision.<sup>53</sup>

It appears that the Ohio Legislature participates directly in the “nuts and bolts” of utility regulation and that the Ohio courts apply a strict “primary direct benefit” test to utility expenses or investment included in rates.<sup>54</sup> This is not the situation in Minnesota. There has never been a contention, to this writer’s knowledge, that the Minnesota commission does not have the authority that it has been exercising in extraordinary property loss cases.

48. OHIO REV. CODE § 4909.15(A)(4) (Page 1981).

49. 67 Ohio St. 2d at 164, 423 N.E.2d at 827 (footnote omitted).

50. Seventy-five percent completion of the project is required to qualify for rate base inclusion. OHIO REV. CODE § 4909.15(A)(1) (Page 1981).

51. 67 Ohio St. 2d at 162, 423 N.E.2d at 826.

52. See Brief of Amicus Curiae, Edison Electric Institute at 2, Cleveland Elec. Illuminating Co. v. Office of Consumers’ Counsel, 67 Ohio St. 2d 153, 423 N.E.2d 820 (1981), *appeal dismissed*, 455 U.S. 914 (1982).

53. 67 Ohio St. 2d at 162 n.6, 423 N.E.2d at 826 n.6.

54. Other cases in which the regulator disallowed any recovery of precertification abandonment losses include Northern States Power Co., Case No. 10,097 (N.D. P.S.C. Dec. 31, 1980), *reversed sub nom.*, Northern States Power Co. v. Hagen, 314 N.W.2d 32 (N.D. 1981); Arizona Pub. Serv. Co., 38 P.U.R.4th 547 (Ariz. P.S.C. 1980).

## V. PERSONAL OBSERVATIONS

In this writer's view, recent opposition to recovery in rates of utility abandonment losses is based upon a less than adequate understanding and analysis of the principles underlying investment in public utility enterprises. Lack of recovery will result in short-term ratepayer advantage, but cause a long-term detriment.

A public utility accepts the duty to construct new facilities to meet future needs, regardless of the relative risk-benefit relationships that exist from time to time. The private sector investor expands plant only when it believes it can beat its competitor to the expected profits. The utility's prices, in contrast, are set by regulation based on a rate of return on invested capital. It is given the opportunity, but no guarantee, to earn on those investments in most cases only after the facilities have been put into actual utility service. The free market investor has no lid on either future profits or losses. Profits and losses are affected primarily by competition. Thus, the free market investor can build pre-construction costs into present prices if desired. There is, therefore, no real basis upon which to directly compare utility and non-utility abandoned project loss recovery.

If a utility has made a prudent investment on behalf of its customers it should be allowed to recover that investment through depreciation or amortization. Further, the utility should receive a return on its investment until recovery is complete. The Iowa Commerce Commission put it well in a recent ruling:

[T]he ratepayer-investor dichotomy has yielded to concepts of basic equity and reason. Rate base has been expanded to include not only plant used and useful but also, in most jurisdictions, the investment in working capital, plant held for future use, construction work in progress upon which interest can be reasonably accrued, and in a few jurisdictions even to all of construction work in progress, speculative investment in gas leases and similar non-operating investments. . . .

Regardless what extent we have recognized it in the past, we now formally acknowledge that that which is dedicated to public use is the invested capital not what that capital purchases. Within the timing constraints of proper revenue-cost matching and the requirement of prudent management, the investor is entitled to a fair rate of return on the invested capital and a return of that capital no more no less.

In effect, this Accounting Ruling culminates the 50-year transition from rate making based on physical plant and defini-

tional dichotomies to rate making based [on] invested capital and financial equities.<sup>55</sup>

One impediment to the Iowa approach has been the feeling that recovery of the carrying costs on abandoned projects runs afoul of the used and useful concept in ratemaking. That concept arose in *Smythe v. Ames*,<sup>56</sup> wherein utilities were given constitutional protection requiring that the fair or current value of property, usually a replacement cost, be used in computing a fair return. This was based on the concept that utility company property is taken and dedicated to the public use and compensation must be paid to the utility based on the fair (current) value of the property to the public. Any utility property not used and useful would not have any current value as public property. Justice Brandeis urged rejection of these concepts in his dissent in *State of Missouri ex rel. Southwestern Bell Telephone Co. v. Public Service Commission*.<sup>57</sup> He favored a return based upon prudently invested capital and later advocated including prudent investment in scrapped plant no longer used and useful.<sup>58</sup>

*Smythe v. Ames* fair value ratemaking was discarded in the cases including and following *Federal Power Commission v. Hope Natural Gas Co.*<sup>59</sup> The used and useful language, however, continues in legislation and becomes a malleable concept to include or exclude working capital, construction work in progress, amortized pre-construction and post-construction losses, plant held for future use, and excess plant capacity. Courts will approve a return on unamortized property loss balances allowed by public service commissions subjected to used and useful challenge,<sup>60</sup> but apparently will not jump at the opportunity to determine what appears to be a substantial question of confiscation, at least where the question is raised in the context of statutory construction.<sup>61</sup>

Neither analogy to private sector investment losses nor the used and useful concept form a reasonable basis to reject full recovery by the utility shareholder of prudent investments gone bad. The

55. Union Elec. Co., Docket No. U-558 (Iowa C.C. Nov. 14, 1975), at 3.

56. 169 U.S. 466 (1898).

57. 262 U.S. 276, 306-07 (1923) (Brandeis, J., dissenting).

58. *Pacific Gas & Elec. Co. v. City of San Francisco*, 265 U.S. 403, 424-25 (1924) (Brandeis, J., dissenting).

59. 320 U.S. 591, 602-03 (1944).

60. See, e.g., *Washington Gas Light Co. v. Baker*, 188 F.2d 11 (D.C. Cir. 1950), cert. denied, 340 U.S. 952 (1951).

61. See *Office of Consumers' Counsel v. Public Util. Comm'n*, 67 Ohio St. 2d 153, 423 N.E.2d 820 (1981), appeal dismissed, 455 U.S. 914 (1982).

issue, rather, is one of sound public policy. At present, in most jurisdictions resolution of the issue seems to be left to the scrutiny and discretion of regulators. Denial of such recovery will certainly affect investors' perceptions of the risk of utility securities and increase the costs of capital. As two recent articles make clear, it is no secret that most utilities in the United States are in financial trouble and the denial of recovery of abandonment costs would have profound effects. In an article entitled *Our Nation's Gas and Electric Utilities: Time to Decide*,<sup>62</sup> authors Charles Cicchetti and Rod Shaughnessy state:

As a nation we are approaching a turning point and are faced with two alternative futures. One view of the future contains a strong viable utility industry which continues to provide electric and gas services to our homes, factories, stores, and offices. In the other view we will continue our current path of weakening our public utilities which, at least in the past, were the lifeblood of our industrial society. Our lights probably will not go out and our businesses and schools probably will continue operating. In this latter view, however, our nation's economic choices will be restricted and our ability to compete in world markets reduced. Failure to avoid this future will mean that we will all pay more as consumers of energy, taxpayers, and job seekers.

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Consider the following financial characteristics. The typical regulated company (1) is earning a negative real return on equity (considering inflation), (2) receives a negative risk premium on equity, (3) can sell new equity only by expropriating the assets of existing stockholders, (4) faces a financial downgrading of its debt instruments if it has an appreciable investment or sales expansion program, and (5) electric utilities receive a substantial portion of their income in the form of deferred tax credits or allowance for funds used during construction, and, therefore, might be forced to borrow money to pay cash dividends.

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Our nation's gas and electric utilities are in financial difficulty. Political pressure is still being brought to bear on them. Without a dramatic reversal it is safe to conclude that matters will get far worse. The ultimate losers are: (1) those consumers that pay prices that could be lowered; (2) taxpayers that must

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62. Cicchetti & Shaughnessy, *Our Nation's Gas and Electric Utilities: Time to Decide*, PUB. UTIL. FORT., Dec. 3, 1981, at 29.

pay more as industry emigrates to other countries; and (3) people seeking work in a contracting economy. In short, we all lose if we continue down this path.<sup>63</sup>

Similarly, New York Public Service Commission Administrative Law Judge Frank S. Robinson concludes that there are few if any instances in which the shareholder should be saddled with any of the costs of an abandoned utility facility or project.<sup>64</sup>

The best policy for Minnesota would be a clear legislative statement that Minnesota utilities will be allowed to recover prudent investment in utility facilities. Utilities should be allowed a return on prudently invested capital until it is recovered through depreciation or amortization.

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63. *Id.* at 29-33.

64. Robinson, *Utility Fiascoes—Who Should Pay?* PUB. UTIL. FORT., Dec. 17, 1981, at 17.

