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RATEMAKING TREATMENT OF ABANDONED GENERATING PLANT LOSSES

RODNEY A. WILSON†

I.	INTRODUCTION—THE CRUX OF THE PLANNING PROCESS	343
II.	PROCEEDINGS BEFORE THE FEDERAL ENERGY REGULATORY COMMISSION	345
	<i>A. The Precedent Established by New England Power Company</i>	345
	<i>B. The Test of Prudence</i>	346
	<i>C. The Appropriate Amortization Period</i>	347
	<i>D. What Constitutes an Equitable Sharing Between Rate-payers and Investors?</i>	347
	<i>E. Northern States Power's Tyrone Energy Park</i>	349
III.	STATE PROCEEDINGS	352
	<i>A. Cases Allowing Amortization Only</i>	352
	<i>B. Determining the Prudence of Decisions to Build and Cancel</i>	353
	<i>C. Conflicting Treatment of AFUDC</i>	354
	<i>D. Monitoring the Need for the Project</i>	355
	<i>E. Cases Also Allowing Inclusion in Rate Base</i>	356
	<i>F. Cases Disallowing Amortization</i>	357
IV.	CONSTITUTIONAL QUESTIONS	359
	<i>A. The Office of Consumers' Counsel Decision</i>	359
	<i>B. Does Denial of Recovery Constitute Unconstitutional Confiscation?</i>	359
V.	CONCLUSION	361

I. INTRODUCTION—THE CRUX OF THE PLANNING PROCESS

Planning for additional operating capacity has become increasingly complex in recent years because of two factors. First, the

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lead time required from the moment utility management determines it will need additional operating capacity until the proposed plant is operational has increased in recent years. This is primarily because of increased regulatory requirements at both the federal and state levels and the more complex technology of new generating plants. Second, while the lead time has increased, the difficulty of forecasting future demand accurately is compounded by the unanticipated level of conservation resulting from the escalating cost of electricity. The OPEC oil embargo of 1973, which pushed up the price of oil dramatically, shocked the energy-consuming public with long waits in gasoline lines and ten to thirty percent annual increases in electric and natural gas bills. For the first time, energy consumers took conservation seriously and conservation became a significant factor in forecasting and planning for energy needs.

The elasticity of demand for electricity is greater than some utility forecasters believed. For a period of time, forecasters continued to extrapolate the old linear growth rates of past demand on into the future. Utility forecasters, however, confronted with an ever-declining load growth and annual downward revisions in forecasts, came to realize that conservation is a long-run phenomenon. This made forecasting demand considerably more difficult. Utilities and their regulating commissions are now involved in very sophisticated and difficult energy needs analyses.

Longer lead times and the substantial planning required forced utilities to spend many millions of dollars before actual construction of plants. Utilities increasingly find that millions of dollars have been spent in engineering and environmental studies, site acquisition, and numerous regulatory proceedings for a plant which current forecasts show is no longer required. This is particularly true in the northeast and midwest states where growth in electric demand has slowed relative to other regions in the country.

Regulators must decide how to treat these huge losses. Such decisions entail consideration of numerous issues. For example, who should bear the risks of these losses, investors or ratepayers? Should there be some sharing of the risks? Various technical ratemaking issues need to be addressed by a commission in deciding how to treat a \$100,000,000 loss from a cancelled generating plant.

This article surveys the regulatory treatment of losses from cancelled generating plants by both the Federal Energy Regulatory

Commission and state commissions. It discusses the issues that arise and how commissions treat these losses for ratemaking purposes. It concludes with specific suggestions designed to mitigate the magnitude of these losses.

II. PROCEEDINGS BEFORE THE FEDERAL ENERGY REGULATORY COMMISSION

A. *The Precedent Established by New England Power Company*

The Federal Energy Regulatory Commission (FERC) established its policy on the ratemaking treatment of abandoned generating plants in *New England Power Co.*¹ New England Power Company (NEP) cancelled plans to construct an oil-fired generating plant, known as the Salem Harbor Project, in November 1975. At that phase of its planning, the company had expended approximately \$13,150,000 for site preparation, environmental studies, engineering services, and cancellation charges. The after-tax net loss of this project was \$7,023,000. NEP sought to amortize the loss over a five-year period and to include the unamortized portion of the losses in its rate base,² thereby earning a return on these amounts.

The Administrative Law Judge (ALJ) denied rate base treatment of the unamortized costs but did allow amortization of the losses to ratepayers.³ The ALJ reasoned that while it was beyond dispute that the company should recover the costs of what was a prudent investment at the time, there was no precedent for affording rate base treatment for such an expenditure. "Ratepayers are not required to insure that a utility receive a return on all monies invested in the enterprise; ratepayers are required to pay a return only on those investments in properties that are used and useful in the public service."⁴

FERC, for the most part, affirmed the decision of the ALJ. It concluded that, in extraordinary losses of this nature, there should be an equitable sharing of the losses between shareholders and

1. *New England Power Co.*, 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).

2. For ratemaking purposes, a utility's rate base is the value of its total property dedicated to the provision of utility service. In most jurisdictions, it is valued at original cost less depreciation. Equity investors earn a return only on the rate base established by the regulatory commission.

3. *New England Power Co.*, 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).

4. *Id.* slip op. at 29.

ratepayers.⁵ Ratepayers are "burdened" when required to pay alone for the total investment loss amortized over a period of years. Investors should be required to share in this loss by forfeiting a return on the unamortized balance of the investment loss.⁶

FERC, however, reversed the ALJ and permitted a five-year amortization of the gross, rather than after-tax, amount of the loss, reasoning that the impact would not place an undue burden on the ratepayers. FERC further reasoned that unless investors are shielded from the risks of losses arising from aborted generating projects, the cost of capital would become higher to compensate for the additional risk assumed. Thus, the risk of an investment in a proposed generating plant is to be borne by the ratepayer, either directly through the cost of service or indirectly through a higher rate of return.⁷

B. *The Test of Prudence*

In *Southern California Edison Co.*,⁸ FERC had a second opportunity to address the appropriate treatment of abandoned generating projects. At issue was the cancellation loss of two generating units, the Huntington Beach Power Plant Project and the Vidal Nuclear Plant Project. The commission further articulated the issues involved in the treatment of abandoned plant losses as: (1) whether the company had proved the prudence of the abandonment decision; and (2) whether the expense was atypical and therefore should not be perpetuated in the cost of service.

The commission split in its treatment of the two abandoned plants. It allowed the losses associated with the company's Huntington Beach Power Plant to be reflected in the cost of service⁹ because the expenses were prudently incurred, not atypical, and were becoming increasingly common to the utility industry.¹⁰ The commission disallowed recovery of the Vidal Nuclear Plant abandonment because the company failed to prove the prudence of the abandonment, not having presented specific evidence justifying the loss.¹¹

5. *Id.* at 31.

6. *Id.* at 30.

7. *Id.* at 33.

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

9. *Id.* slip op. at 8-9.

10. *Id.*

11. *Id.*

C. *The Appropriate Amortization Period*

The appropriate period of time over which an abandonment loss should be amortized was considered in *Louisiana Power & Light Co.*¹² The utility sought to recover losses of \$13.6 million arising from abandonment of plans to construct a two-unit nuclear plant known as the St. Rosalie project. The company sought to amortize the losses over a five-year period. Intervenor groups contested this amortization period, recommending that it be extended to coincide with the useful life of the project had it been completed, twenty-five years in this instance.¹³ An extended amortization period would also mitigate the impact on ratepayers. The ALJ and the commission adopted the company's proposed five-year amortization because the shorter amortization period, with its quicker recovery, would lessen the burden of carrying charges. The commission also determined that the cost of service would be credited with the tax deductions taken on the loss.¹⁴ Following *New England Power*, the ALJ and the commission found that investors should share in the loss.

D. *What Constitutes an Equitable Sharing Between Ratepayers and Investors?*

The above three cases indicate that FERC considers an equitable sharing of losses between ratepayers and investors to be one in which the total investment loss is amortized to ratepayers while investors are denied a return on the unamortized amounts. Whether such treatment results in a truly equitable sharing of the loss is subject to debate and should include other ratemaking considerations. A mere "balancing" of the absolute losses of ratepayers versus investors indicates that such a "splitting" may not be equitable. For example, on a hypothetical cancellation loss of \$100,000,000 to be amortized over five years, ratepayers would pay through their rates approximately \$100,000,000. If the loss is not included in rate base, investors will not earn a return on their \$100,000,000 investment, although they will recover their investment over five years. Assuming FERC allowed the utility to earn a ten percent return on its rate base, investors would be denied \$25,000,000 in earnings over the five-year period in this hypotheti-

12. Op. No. 104, Docket No. ER77-533, [1979-1982 Transfer Binder] UTIL. L. REP. (CCH) ¶ 12,392 (F.E.R.C. Feb. 12, 1981).

13. *Id.*

14. *Id.*

cal loss.¹⁵ Thus, in this hypothetical illustration, ratepayers pay \$100,000,000 for a cancelled plant which obviously will not provide any power, while investors forego \$25,000,000 in prospective return.

Two further considerations in determining an equitable sharing of the cancellation loss are the ratemaking treatment of accumulated Allowance for Funds Used During Construction (AFUDC)¹⁶ and the tax savings resulting from the loss. In all probability, the utility has been capitalizing AFUDC on the project. In some cases the total loss the company seeks to amortize also includes the equity portion of AFUDC.¹⁷ Is it fair that the AFUDC accumulated on the equity portion of the investment be collected from ratepayers? Arguably, allowing the equity portion of AFUDC to be in-

15. For purposes of this hypothetical, it is assumed that the rate base is calculated each year by taking the average of the beginning and end of year plant balances as the total rate base. It is further assumed that the commission allows a 10% return on the calculated rate base amounts. The loss will be amortized over five years on \$20,000,000 per year. Based on a five-year amortization period, the rate base calculation in year one for the hypothetical \$100,000,000 loss would be \$90,000,000 (\$100,000,000 beginning of year amount + \$80,000,000 end of year amount divided by two). A 10% return applied to the \$90,000,000 rate based amount equals \$9 million, the return the investor would have earned had the loss been permitted in rate base. In year two, the rate base would be \$70,000,000 (\$80,000,000 + \$60,000,000 divided by two). The return would be 10% × \$70,000,000 or \$7 million. In year three, the return would be \$5 million (10% × \$50,000,000); \$3 million in year four (10% × \$30,000,000); and \$1 million in year five (10% × \$10,000,000). Had the loss been permitted in rate base, investors would have earned \$25,000,000 over this five-year period.

16. Allowance for Funds Used During Construction (AFUDC) is an accounting concept for utility ratemaking purposes. It allows the utility to earn a deferred return on construction work in progress (CWIP). As a general rule, commissions, either because of statute or policy, do not allow a utility to earn a current return on funds tied up in on-going construction projects. In order to accord some financial relief, albeit deferred, a commission will permit a utility to take a AFUDC on a particular construction project. The accounting treatment is, for example, to allow an on-going generating plant under construction in rate base (thereby earning a current return) and to simultaneously credit income (or to take AFUDC) for the earnings on the construction. Thus, there is a "crunch" in terms of real current income to the utility. The AFUDC is, however, capitalized (as opposed to currently expensed) and added to the value of the project. When the plant eventually does become operational, the utility not only earns a current return on the original cost of the plant but also on the amount of capitalized AFUDC.

17. It is assumed that a utility finances a major construction project such as a generating plant with a mix of common stock (or equity), preferred stock, and debt. A typical capital structure for a utility would be 40% common equity, 55% long-term debt, and 5% preferred stock. Assuming a utility finances a new generating plant until it achieves the same proportionate mix of financing as its existing capital structure, 40% of the investment in the plant could constitute common stock. AFUDC is taken on the entire investment. Thus, 40% of the total AFUDC relates to the equity or common stock portion of the total investment.

cluded in the total amount to be amortized permits investors some return on the investment.

Another issue that arises in the equitable sharing of losses is the ratemaking treatment of tax savings. Cancellation losses are deductible and serve to lower the utility's tax liability. A utilities commission must determine whether this tax saving should reduce the cost of service so the tax saving accrues to the ratepayer. As discussed above in *New England Power*, the ALJ allowed only amortization of the net-after-tax cancellation loss, thereby giving the benefit of the tax saving to ratepayers. FERC reversed the ALJ on this point and allowed the gross or before-tax amount of the loss to be amortized.

E. Northern States Power's Tyrone Energy Park

Two recent FERC decisions have affirmed the ratemaking treatment of losses established in these two earlier cases.¹⁸ The one generating the most controversy is *Northern States Power Co.*¹⁹ The losses involved in that case were substantially greater than in prior cases before FERC. Northern States Power Company (NSP),²⁰ along with three co-owners, cancelled plans to build a nuclear unit known as the Tyrone Energy Park after the Wisconsin Public Service Commission refused to certify the need for the proposed project. NSP's portion of the total cancellation loss was approximately \$75,000,000.²¹ This amount entailed \$35,000,000 in actual expenses and \$40,000,000 in estimated contract termination costs. In accord with the precedent established in *New England Power*, NSP did not seek rate base treatment for the unamortized portion of the loss.

Numerous issues were raised by the various intervenors in the

18. In *Virginia Elec. & Power Co.*, Op. No. 118, Docket No. ER78-522, [1979-1982 Transfer Binder] UTIL. L. REP. (CCH) ¶ 12,432 (F.E.R.C. July 30, 1981), the commission allowed the amortization of the loss arising from the 1977 abandonment of two nuclear units at Surry, Virginia, while denying rate base treatment of the unamortized amount. Neither the prudence of the abandonment decision nor the perpetuation of the expense in cost of service was at issue. The company argued that since the decisions to build the plant and then cancel were prudent, investors should not be penalized by the denial of a return on the unamortized costs. The ALJ and the commission rejected this argument.

19. 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. Northern States Power Company consists of Northern States Power of Minnesota (NSP-M) and Northern States Power of Wisconsin (NSP-W). NSP-W is the wholly-owned subsidiary of NSP-M.

21. Later reduced to \$67,000,000.

proceeding. Intervenor objected to both cost components, arguing that the estimated costs were too speculative and that all salvageable items had not been excluded from the actual expenses. In addition, the Minnesota, North Dakota, and South Dakota utilities commissions argued that NSP's proposal to allocate approximately eighty-seven percent of the total loss to their states was unfair because the Wisconsin Public Service Commission had improperly denied the certificate of need by looking only to the needs of western Wisconsin.²²

The ALJ rejected the arguments of the intervenors, finding that the use of reasonable estimated cancellation costs was permissible.²³ The ALJ also found that the unique circumstances giving rise to the abandonment (not because of declining load forecasts but because of the Wisconsin commission's decision) were not relevant to the issue of the appropriate allocation of the loss between the states.²⁴

The ALJ also excluded the common equity portion of AFUDC from the amount to be amortized.²⁵ The ALJ believed that the decision made clear that the investors in an aborted project must bear the risk of not receiving a return on their common equity construction investment. It was appropriate to exclude the common equity portion from the amount to be amortized because this part of AFUDC represented a return to investors. The ALJ further concluded that consistent with the *New England Power* decision, NSP should be permitted to amortize the before-tax loss.²⁶ The federal income tax treatment of the loss had resulted in a \$37.5 million tax savings. The ALJ viewed these deferred taxes, which the company proposed to normalize,²⁷ as ratepayer-contributed capital and ordered that the rate base be reduced by the un-

22. Northern States Power Co., Docket No. ER79-616, 13 F.E.R.C. ¶ 65284-5 (Dec. 4, 1980) (Initial Decision on Nuclear Plant Cancellation Loss), at 7.

23. *Id.* at 21-22.

24. *Id.* at 8.

25. *Id.* at 24.

26. *Id.*

27. There are two methods for the ratemaking consequences of accelerated depreciation. By accelerating depreciation in the early years of an asset's life, the utility has a greater tax deduction and thus a lower tax liability. In effect, some of the tax liability is deferred to the future. Under a "normalization" approach, a utility does not pass through the tax benefits resulting from accelerated depreciation to its ratepayers, but "normalizes" the tax consequences as it affects utility rates as if the utility were taking straight-line depreciation. The alternative approach is "flow-through." This method would flow through the tax benefits to the ratepayers immediately, but theoretically increase the tax liability (and hence rates) in the future.

amortized balance in the deferred income tax account.²⁸ Thus, ratepayers would share in the tax benefit.

FERC generally adopted the ratemaking treatment proposed by the ALJ, but made two important exceptions. First, it disagreed with the ALJ that the deferred tax reserve associated with the tax saving should be offset against rate base.²⁹ The commission concluded that the ALJ had erred in his conclusion that ratepayers contributed to the deferred tax reserves, finding that the funds used by NSP during the pre-certificate period were derived solely from the investors and that the ratepayers had made no contribution prior to abandonment. Over the amortization period, the ratepayers gradually reimburse NSP for its investment. This contribution, however, will be offset each year by a portion of the normalized tax benefits.³⁰

Second, FERC rejected the ALJ's disallowance of the common equity portion of AFUDC.³¹ Of the total estimated cancellation loss, \$4,869,293 represented AFUDC accrued to the date of project termination. Of this amount, \$3,201,900 represented AFUDC related to the investment of common equity shareholders. The commission clarified its *New England Power* decision, stating that it intended to allocate the carrying costs during the amortization period to shareholders, while AFUDC accruing prior to abandonment would be borne by ratepayers.³² It reasoned that prior to abandoning a project, the carrying costs on investment are a legitimate expense of the project just as are more tangible costs, such as, parts and materials.³³

FERC's policy on the ratemaking treatment of abandonment losses is now well settled. The utility has the initial burden to show that its decisions to build and later cancel the plant were prudent. Having met this burden, investors and ratepayers will "share" in the loss; ratepayers by paying in rates for the investment loss, investors by not earning a return on the investment. The amortization period is accelerated, typically five years, so as to reduce the carrying charges borne by investors. Finally, FERC

28. Northern States Power Co., Docket No. ER79-616, 13 F.E.R.C. ¶ 65284-5 (Dec. 4, 1980) (Initial Decision on Nuclear Plant Cancellation Loss), at 31.

29. 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).

30. *Id.* slip op. at 6-7.

31. *Id.* at 7-9.

32. *Id.*

33. *Id.*

has resolved other ratemaking issues, such as the tax consequences and the treatment of AFUDC, in favor of investors.

III. STATE PROCEEDINGS

A. Cases Allowing Amortization Only

State commissions accord abandonment losses widely differing treatment. Decisions range from placing the entire burden on investors, to a "sharing of the losses," to placing the entire burden on ratepayers. A number of state commission decisions adopt FERC's treatment and allow the amortization of the investment but disallow rate base treatment for the unamortized amount. For example, both the Virginia and West Virginia commissions followed this treatment for the intrastate portions of Virginia Electric and Power Company's (VEPCO) cancellation of Surry Units 3 and 4. In *Virginia Electric & Power Co.*,³⁴ the Virginia commission allowed a ten-year amortization of the cancellation loss. The commission concluded that it is equitable to require investors to assume some of the risks of cancellation by forfeiting the expected return. It reasoned that even though VEPCO is a regulated monopoly, ratepayers should not bear investment risks. The commission found that, based on traditional business practice and economic theory, the burden should be shared. It held that ratepayers should not be required to pay a return on projects when there is no promise that they will ever be used.³⁵

The West Virginia commission made more detailed findings on the utility's reasons for the cancellation. It found that the units were cancelled because of declining load forecasts and difficulties experienced by the company in raising capital. Consistent with the Virginia commission, the West Virginia commission also allowed the ten-year amortization of the cancellation costs. It, however, denied rate base treatment of the unamortized amounts, stating, "Denying rate base treatment of the unamortized costs causes a sharing of the risk of the project between consumer and company, a reasonable approach since neither group was responsible for the fate of the project."³⁶

34. *Virginia Elec. & Power Co.*, 29 P.U.R. 4th 65 (Va. Corp. Comm'n 1979).

35. *Id.*

36. *Virginia Elec. Power Co.*, Case No. 79-040-E-42T (W. Va. P.S.C. Feb. 1, 1980), at 4.

B. Determining the Prudence of Decisions to Build and Cancel

The Michigan Public Service Commission has dealt with the treatment of abandonment losses in two instances, one involving Consumer Power Company and the other Detroit Edison Company. In these cases, the commission looked carefully to management's actions, with respect to the decisions to build and later to cancel the project, to determine whether the company had acted prudently.³⁷ A finding of prudence is a prerequisite to the allowance of any amortization of costs.³⁸ In *Consumer Power Co.*,³⁹ the utility cancelled plans to construct two 1,150 megawatt nuclear units in Bay County, Michigan. The company listed several factors for the cancellation, including the severely depressed market for the company's securities, its low earnings, and its need to raise additional capital for other capital projects then in advanced stages of development.⁴⁰ Prior to the project's inception, the utility had spent approximately \$14,900,000 exclusive of land costs.⁴¹

The commission made detailed findings to determine whether management acted prudently during the project planning and in the decision to abandon. It found the company acted prudently in commencing planning, site acquisition and improvement, and in making contractual commitments for other projects based upon the company's load-growth forecasts. The commission also found that deferring and ultimately cancelling the project was prudent, citing the revised load-growth forecasts, the inability to raise the necessary capital, and the further rigidity of nuclear licensing requirements that extended projected in-service dates. The commission allowed the amortization of the losses over a ten-year period, consistent with its practice of allowing the amortization of extraordinary losses when these losses result from reasonable and prudent decisions by the utility. The commission disallowed rate base treatment of the unamortized portions because the company failed to demonstrate that such amounts would ever be useful in providing service to its customers.⁴²

37. See *Detroit Edison Co.*, Case No. U-6474 (Mich. P.S.C. Oct. 29, 1981); *Consumer Power Co.*, Case No. F-700 (Mich. P.S.C. Feb. 10, 1975).

38. *Detroit Edison Co.*, Case No. U-6474 (Mich. P.S.C. Oct. 29, 1981), at 6; *Consumer Power Co.*, Case No. F-700 (Mich. P.S.C. Feb. 10, 1975), at 5.

39. Case No. F-700 (Mich. P.S.C., Feb. 10, 1975).

40. *Id.* at 3.

41. *Id.* at 3-4.

42. *Id.* at 6. The Michigan commission accorded the same ratemaking treatment to Detroit Edison Company for the cancellation relating to its Greenwood Nuclear Units 2

C. *Conflicting Treatment of AFUDC*

State commissions are also split over the appropriate treatment of AFUDC. In *San Diego Gas & Electric Co.*,⁴³ the California commission disallowed AFUDC from amounts to be amortized. *San Diego Gas* involved the cancellation of a nuclear plant with \$90,000,000 of incurred expenses. The commission also reviewed whether the decisions to proceed and later abandon the project were prudent. The recovery of accumulated AFUDC was disallowed on the following grounds:

Considerations of equity also support the disallowance of accumulated Sundesert AFUDC. While recognizing SDG&E's promotion and development of the Sundesert project was not imprudent, the commission finds itself neither disposed nor entitled to shield the utility's investors from all risks associated with its new plant investments. Ratepayers ought not to bear the entire burden of the failed project, and certainly not to the extent of providing a return on funds invested therein.⁴⁴

The Maine commission also excluded accumulated AFUDC amounts in the abandonment of the Sears Island Nuclear Plant by Central Maine Power. The circumstances giving rise to the abandonment of the project were unique. After the incurrence of \$9,686,000 on pre-certification studies and \$4,496,600 on prepayments for nuclear enrichment services, the company discovered a geological fault at the proposed site and was forced to abandon the project. The commission held that the risks of the project must be balanced between the ratepayers and shareholders. It allowed the amortization less accumulated AFUDC, but denied rate base treatment of the unamortized portion.⁴⁵

The Vermont Public Service Board reached the opposite con-

and 3, each 1200 MW units. The company cancelled the project citing increasing uncertainty in licensing, economic conditions, and financial markets and the clear lack of a strong national policy regarding nuclear power. Again, the commission emphasized that the company's accounting treatment should be granted if it shows that the decisions to initiate, continue, and cancel the project were reasonable and prudent given the facts and circumstances that existed or were reasonably foreseeable at the time the decisions were made. The commission adopted the same precedent with respect to amortization and rate base treatment as in *Consumer Power Co.* and relied on the same reasoning. *Detroit Edison Co.*, Case No. U-6474 (Mich. P.S.C. Oct. 29, 1981), at 7-9.

43. 31 P.U.R.4th 435 (Cal. P.U.C. June 5, 1979).

44. *Id.* at 447.

45. *Central Maine Power Co.*, Docket Nos. 80-25, 80-66 (Me. P.U.C. Oct. 31, 1980). The Massachusetts Public Service Commission also excluded AFUDC from amounts to be amortized in *Western Massachusetts Elec. Co.*, D.P.U. 558 (Mass. Dep't P.U. July 31, 1981).

clusion in its treatment of AFUDC in the abandonment of Vermont Public Service Corporation's ownership share of two electric generating units proposed to be located in Montague, Massachusetts. The lead utility in this project was Northeast Utilities Company. Central Vermont's ownership share was only 1.73% of the project. The commission allowed amortization of all costs, including AFUDC, associated with Montague over a five-year period. Unlike the California and Michigan decisions noted above, the Vermont board assumed that the costs were prudently incurred and found that the company did not have an affirmative obligation to prove that the costs were prudent. The commission placed the burden on those intervenors who would argue that the expenditures were imprudent.⁴⁶

D. Monitoring the Need for the Project

All of the abandonments discussed so far were considered by the commissions after the decision to abandon was made. Review of the prudence of management's actions was based on hindsight. Most of the facts and circumstances surrounding the decisions to build and later to cancel were probably presented to the commissions by the companies. Intervenors generally have little knowledge and information to advocate a case of imprudence.

In *Connecticut Light & Power Co.*,⁴⁷ which also dealt with the Montague plant, the commission attempted to monitor the need for the plant during its planning phase. The project was initially undertaken in 1973. In a 1977 proceeding, the commission informed the company that continued involvement in the project was "ill-advised." Notwithstanding this admonition, the company continued with the project. In December of 1980, the companies involved finally decided to cancel the project. Connecticut Light & Power then sought to recover its expenses.

The commission's independent review of the continuing need for the project resulted in its decision to spare ratepayers from reimbursing the investment losses incurred after 1977.⁴⁸ Arguably, had the companies heeded the commission's advice in 1977, the investors would also have been spared these losses. The Connecticut commission's appraisal of the continued need for the project is

46. Central Vermont Pub. Serv. Corp., Case Nos. 4496, 4504 (Vt. P.S. Bd., Dec. 4, 1981), at 13.

47. Docket Nos. 810602, 810604 (Conn. Div. P.U. Dec. 2, 1981).

48. *Id.* at 42-43.

particularly interesting since the Vermont and Massachusetts commissions⁴⁹ allowed the full amortization of expenditures for the abandoned Montague plant. Continued monitoring of on-going expenditures and assessment of need based upon the latest load forecasts could well hold down the magnitude of losses in future abandonments.⁵⁰

E. Cases Also Allowing Inclusion in Rate Base

Some state commission decisions have placed the entire burden of abandonment losses on ratepayers. These decisions have both allowed the amortization of expenses incurred and required ratepayers to pay a return on unamortized portions of the loss. For example, in *Union Electric Co.*,⁵¹ the Iowa commission allowed the unamortized portions for Union's Rush Island coal-fired generating plant abandonment in its rate base. The commission reasoned that what is dedicated to the public service by the investor is capital and not what that capital purchases. It is this capital upon which the investor should earn a fair return.

The same treatment of abandonment losses was given to Carolina Power and Light Company by the North Carolina Utilities Commission. In *Carolina Power & Light Co.*,⁵² the company abandoned a project that involved over \$7,000,000 in costs. Finding that the decision to abandon was reasonable and prudent, the commission allowed a five-year amortization of the costs and inclusion of the unamortized balance in rate base.

In *Gulf Power Co.*,⁵³ the Florida Public Service Commission noted that the company's proposal to abandon its proposed generating plant and to purchase power from Georgia Power Company would be beneficial to Gulf's ratepayers. The commission allowed the unamortized portion of the losses to be placed in rate base and amortized over a five-year period.⁵⁴

49. The Massachusetts commission dealt with the Montague abandonment in Western Massachusetts Elec. Co., D.P.U. 558 (Mass. Dep't P.U. July 31, 1981). While the commission was aware of the Connecticut commission's position, it could not agree that expenditures incurred after 1977 were imprudent. It allowed the amortization of all amounts expended but excluded accumulated AFUDC.

50. In this regard, see the recommendations contained in Allison, *Judging the Prudence of Constructing Nuclear Power Plants: A Report to the Oklahoma Corporation Commission*, 15 TULSA L.J. 262 (1980).

51. Docket No. U-558 (Iowa C.C. Nov. 14, 1975).

52. Docket No. E-2, Sub. 336 (N.C. U.C. Apr. 22, 1980).

53. Docket No. 800001-EU (Fla. P.S.C. Nov. 10, 1980).

54. *Id.* at 7.

In *Wisconsin Electric Power Co.*,⁵⁵ the Wisconsin commission proposed alternate ratemaking treatment of the pre-certification expenses in the company's proposed nuclear plant depending upon future action taken by the company. The commission determined that if the company continued its application for the project, the investment would be amortized over three years without the inclusion of the unamortized balance in rate base. If the company chose instead to withdraw the application and abandon the project, the commission would allow rate base treatment of the unamortized amount in addition to the three-year amortization.

F. Cases Disallowing Amortization

Some state commissions disallow recovery from ratepayers of any costs, thereby placing the entire burden on investors. The principal reason for this disallowance is imprudence. For example, in *Arizona Public Service Co.*,⁵⁶ the company sought to recover expenses in cancelling the construction of Palo Verde Units 4 and 5 in California. This project was a joint project proposed to be built by Arizona Public Service in conjunction with other utilities.

The commission decided that none of the expenses in the cancellation loss should be amortized to ratepayers. Four independent reasons were cited. First, it was incumbent upon the company to adequately justify each expense claimed during the test year.⁵⁷ The commission held that the justification for the abandonment was conclusory in nature and did not meet this burden. Second, the commission found the expense to be unusual and non-recurring.⁵⁸ Third, the commission stated that the planning for construction of new units is a management function under the control of stockholders. If units are planned and then cancelled, the stockholders should bear any costs related to such cancellations.⁵⁹ Finally, and most importantly, the decision to cancel resulted from adverse regulatory conditions in the State of California that made continued participation by the California utilities uncertain. The commission concluded:

We do not feel it would be appropriate to allow an Arizona utility to recover from Arizona rate payers an expense which

55. Docket No. 05-CE-3 (Wis. P.S.C. Feb. 14, 1980).

56. Docket No. U-1345, Dec. No. 51009 (Ariz. P.S.C. May 29, 1980).

57. *Id.* at 18.

58. *Id.*

59. *Id.*

was triggered by regulatory or other conditions in the State of California. Further, prudent utility management should have negotiated appropriate contractual provisions to guard against and/or recover for such a contingency. Therefore, in our opinion, APS most appropriately looks to other participating utilities in the Palo Verde project or its own stockholders in recovering an expense associated with the cancellation of Palo Verde Units IV and V and not its Arizona rate payers.⁶⁰

The circumstances of the Palo Verde cancellation are very similar to the abandonment of Northern States Power Company's proposed Tyrone Energy Park, to be located in Wisconsin.⁶¹ In separate proceedings before the North Dakota and Minnesota commissions, both commissions disallowed the amortization of expenses associated with the Tyrone Energy Park nuclear plant. In *Northern States Power Co.*,⁶² the Minnesota commission disallowed the amortization of the expenses because the Wisconsin Public Service Commission had acted improperly in denying the certificate of need for the project. The Minnesota commission found that the Wisconsin commission, in determining the need for the proposed facility, only considered the needs of western Wisconsin and did not consider the needs of the four-state service area of Northern States Power Company.⁶³ Evidence in the administrative proceedings before the commission indicated that the decision was made more because of an anti-nuclear bias than an undocumented need for electricity.⁶⁴ Supporting this view was the Wisconsin commission's denial of the certificate of need that authorized NSP to commence plans to build two coal-fired units of approximately the same size as the nuclear unit and to be located at the same site. Inasmuch as Minnesota, North Dakota, and South Dakota were to pay eighty-seven percent of the proposed loss, the Minnesota commission found it unfair that Minnesota ratepayers should have to pay for a loss resulting from what it viewed as an erroneous decision by the Wisconsin commission. Recovery was accordingly denied.⁶⁵

60. *Id.* at 18-19.

61. *See supra* notes 18-33 and accompanying text (discussion of FERC proceedings).

62. Docket No. E-002 GR-80-316 (Minn. P.U.C. Apr. 30, 1981).

63. *Id.* at 17.

64. *Id.*

65. *Id.* at 18.

IV. CONSTITUTIONAL QUESTIONS

A. *The Office of Consumers' Counsel Decision*

A recent decision by the Ohio Supreme Court, overturning the Ohio commission's amortization to ratepayers of losses from four terminated nuclear power plants, has created some controversy.⁶⁶ In a general rate case for Cleveland Electric Illuminating Company, the commission allowed the amortization of the company's investment in four terminated nuclear power plants.⁶⁷ The Ohio Consumers' Counsel appealed the commission's allowance of this amortization, arguing that it violated Ohio's ratemaking statute. The statute, which delineates the service-related costs that a utility may recover from its ratepayers, reads in relevant part, "The Public Utilities Commission, when fixing and determining just and reasonable rates, fares, tolls, rentals, and charges shall determine: . . . (4) the cost to the utility of rendering the public utilities service for the test period."⁶⁸ The court phrased the issue as whether the cancelled plant expenditures represented the cost to the utility of rendering the public utility service for the test period. The court found the extraordinary loss occasioned by termination of the nuclear plants was not an ordinary operating expense under the statute and rejected the commission's argument that a cancellation does not create a past loss but gives rise to a current cost.⁶⁹

B. *Does Denial of Recovery Constitute Unconstitutional Confiscation?*

The Ohio Supreme Court's decision was based upon the particular wording of the Ohio ratemaking statute. The court recognized its decision did not comport with the majority view. One question arising from the court's decision is whether the denial of recovery of the investment, which no party claimed was imprudent, amounts to an unconstitutional taking of property. This argument was not raised before the Ohio Supreme Court by any party to the proceeding until petitions for rehearing were filed. Rehearing was denied by the court without comment. The company appealed the decision to the United States Supreme Court. The appeal was dismissed for lack of a properly presented federal

66. *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).

67. *Id.*

68. OHIO REV. CODE § 4909.15(A) (Page 1981).

69. 67 Ohio St. 2d at 164, 423 N.E.2d at 827.

question.⁷⁰

It appears that there is an arguably unconstitutional taking of property when a utility that has made a substantial investment in serving the public interest is denied a recovery of its investment from ratepayers, assuming that the decision to proceed and later to cancel was reasonable and prudent. While no commissions have directly held as such, this is the majority view. If management acted prudently in its decision to plan for and later to cancel the plant, a majority of jurisdictions would allow amortization of the losses to ratepayers. Most jurisdictions, however, would not include unamortized amounts in the rate base on the grounds that investors should assume some risk of the loss.

Disallowing the unamortized portion of the cancellation losses from rate base does not constitute an unconstitutional taking. This view is supported by the traditional ratemaking treatment allowing a utility to earn only a return on property considered "used and useful" to a company's ratepayers. Inasmuch as the loss arising from the cancellation is not used and useful to the company's ratepayers, there should be no constitutional requirement that investors receive a return on the unamortized portion of the investment, even if the expenditures were entirely prudent when made.

There is substantial support that there is an unconstitutional taking if prudently-expended amounts on a proposed generating plant are not allowed as recoverable expenses in a cancellation. Support for this proposition may be found in a number of cases. For example, as articulated in *Mississippi River Fuel Corp. v. Federal Power Commission*:⁷¹

The character of the rate has always been determined, in our law, by its relationship to the sum of a number of components. Those components, principally, are the expenses of the operation, an allowance for depreciation or depletion, and a proper "return" to the company. . . . A rate order which does not provide for proper allowable expenses, taxes, depreciation and return, is unfair, unreasonable and confiscatory. We thought it unnecessary to recite that obvious basic premise.⁷²

70. 455 U.S. 914 (1982).

71. 163 F.2d 433 (D.C. Cir. 1947).

72. *Id.* at 450-51.

V. CONCLUSION

As noted, a number of cases involving abandonments are pending in various jurisdictions and entail hundreds of millions of dollars in cancellation losses. With the uncertain nature of load forecasting, coupled with the long lead times required to plan and put into service new generating facilities, continued large cancellation losses from abandoned generating projects are expected. To mitigate, if possible, the sizable losses, the following are suggested:

1. Shorten the regulatory decisionmaking process to reduce the lead time necessary to plan and put a plant into operation.

2. Consolidate the regulatory decisionmaking in as few agencies as possible. For example, in Minnesota, the Environmental Quality Board determines the site for the proposed generating plant; the Energy Agency determines and authorizes the certificate of need for the proposed project; and the Public Utilities Commission determines the utility's rates. The Pollution Control Agency also has jurisdiction over some environmental considerations. Consolidating some of this regulatory authority into fewer agencies might compact the regulatory decisionmaking process.

3. Regularly monitor the magnitude and necessity for expenditures on proposed plants. This could be accomplished in a company's general rate filing, an annual occurrence for many utilities.

4. Monitor load forecasts as they are modified to continually assess the demand and need for additional capacity. This should be coordinated with a review of the power supply availability and load forecasts of those utilities in the region's power supply pool.

5. If possible, negotiate vendor contracts to provide for cancellation in event of unforeseen circumstances negating the need for the proposed plant. In a number of abandonments, these "penalty" costs constitute a substantial portion of the total loss.

Utility load forecasting must meet the challenges presented to it and should result in fewer instances of cancelled construction plans after expenditures of millions of dollars. This article provides regulators with information on how to rationally and equitably deal with cancellation losses in ratemaking.

