

Service Date: April 19, 1983

DEPARTMENT OF PUBLIC SERVICE REGULATION
BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MONTANA

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In the Matter of the Application of)	UTILITY DIVISION
PACIFIC POWER & LIGHT COMPANY)	
for Authority to Adopt New Rates and)	
Charges for Electric Service Furnished)	DOCKET NO. 82.7.53
in the State of Montana - ABANDONED)	ORDER NO. 4975
NUCLEAR PROJECTS.)	

APPEARANCES

FOR PACIFIC POWER & LIGHT CO.:

Leonard A. Girard and Nancy M. Ganong; Stoel, Rives, Boley, Fraser & Wyse, 900 SW Fifth Avenue, Portland, Oregon 97204

Calvin S. Robinson and C. Eugene Phillips, Murphy, Robinson, Heckathorn & Phillips, P.O. Box 759, Kalispell, Montana 59901

FOR THE MONTANA CONSUMER COUNSEL:

John C. Allen, Staff Attorney, Montana Consumer Counsel, 34 West Sixth Avenue, Helena, Montana 59624

FOR THE COMMISSION:

Calvin K. Simshaw, Staff Attorney, 1227 11th Avenue, Helena, Montana 59620

BEFORE:

THOMAS J. SCHNEIDER, Chairman
JOHN B. DRISCOLL, Commissioner
HOWARD L. ELLIS, Commissioner
CLYDE JARVIS, Commissioner
DANNY OBERG, Commissioner

FINDINGS OF FACT

A. Background

1. On July 14, 1982, Pacific Power and Light Company (hereafter PP&L or the Company) filed an application seeking authority to raise rates to generate revenues for the amortization of two abandoned nuclear generating projects. The Company proposed to increase its revenues from Montana customers by \$970,000 annually to allow a 5-year amortization of its investment in the Pebble Springs Nuclear Project (Pebble Springs). The Company further proposed that it be allowed to apply the gain from its recent debt/equity exchange to offset amortization of its investment in Washington Public Power Supply System Nuclear Plant Number 5 (WPPSS-5). In the alternative the Company proposed that it be allowed \$1,055,000 additional annual revenues to cover a 5-year amortization of (WPPSS-5).

2. On October 18, 1982, subsequent to a prehearing conference held on September 24, 1982, the Commission issued an order setting forth the procedure to be followed in this docket.

3. Pursuant to proper notice, the Commission conducted public hearings in this docket on January 18 and 19, 1983 at the City Council Chambers in Kalispell, Montana.

B. Position of the Parties

4. PP&L presented testimony in support of its application through the following witnesses at the hearing:

Don C. Frisbee, Chairman of the Board, Chief Executive Officer, PP&L
Herman Roseman, Senior Vice-President, National Economic Research Associates
William E. Wordley, Supervisor of Load Forecasting, PP&L
Dennis P. Steinberg, Senior Power Resources Engineer, PP&L
Lee D. Weislogel, Manager of Nuclear and Shared Generation, PP&L
Robert F. Lanz, Vice-President, PP&L
James T. Watson, Controller, PP&L
David W. Sloan, Manager of Regulatory and Rate Analysis, PP&L

5. Company witnesses described the circumstances which led PP&L to invest in Pebble Springs and WPPSS-5. PP&L serves the northwest corner of Montana as part of a five-state integrated electric system. The demand for electricity in its service area grew at an annual rate of 4.6

percent between 1970 and 1981. (Exh. 1-T, pp. 6-7, Exh. 2, Tables 2-1 and 2-2.) The Company has continually performed load forecasts and has periodically expanded its generation capacity to meet expected increases in demand. It was in response to this expected growth in demand that PP&L decided on October 10, 1974 to become a 29.4 percent owner of the Pebble Springs project and on March 17, 1975 to become a 10 percent owner of the WPPSS-5 project.

6. PP&L decided to terminate its participation in both nuclear plants following abandonment by the primary sponsor in each instance. As of December 31, 1981 PP&L's investment in Pebble Springs was \$83,011,000 (Exh. 12, Table 3). As of the same date PP&L's investment in WPPSS-5 was \$99,092,000 (Exh. 12, Table 5).

7. PP&L has maintained throughout this proceeding that its investment in the Pebble Springs and WPPSS-5 projects was prudent under the circumstances which existed at the time those investments were made. It is the Company's position that it should be allowed to recover its costs associated with the two abandoned projects from its ratepayers because the investments were made with the anticipation that the projects would provide electric service to ratepayers.

8. More specifically, the Company has proposed that it be allowed to recover its costs in the Pebble Springs plant from ratepayers through a five-year amortization with a return of 11.12 percent on the unamortized balance. This would require an increase in annual revenues of \$970,000 to be collected from Montana ratepayers to allow recovery of Montana's allocated share of the investment. PP&L further proposes that it be allowed to apply the gain realized from its recent debt/equity exchange to offset amortization of its investment in the WPPSS-5 plant. In the alternative PP&L would propose that it be granted \$1,055,000 in additional annual revenues to allow a five-year amortization of its WPPSS-5 investment again providing for an 11.12 percent return on the unamortized balance.

9. The Montana Consumer Counsel participated fully in this proceeding and presented testimony through Mr. George Hess and Dr. Caroline Smith. The position of the Consumer Counsel as expressed in Mr. Hess' testimony was presented assuming that the investments were prudent and further that Montana law does not preclude passing the costs of the abandoned projects, including a return on the unamortized investment, on to ratepayers. (Exh. MCC-1, p. 2) Given these

assumptions Mr. Hess proposed first that \$15.9 million representing the common equity component of the accumulated allowance for funds used during construction (AFUDC) be removed from the amount to be recovered. Mr. Hess further proposed that the return on the unamortized balance be reduced to 6.49 percent by removing the weighted cost of common equity. Finally Mr. Hess recommended that the amortization period be at least 15 years long. Mr. Hess' treatment would result in an increased annual revenue requirement of \$558,000 if both projects were amortized over 15 years.

10. Montana Consumer Counsel through witness Dr. Caroline Smith opposed applying the gain from the recent debt/equity exchange as an offset to amortization of WPPSS-5. Dr. Smith maintained that the exchange unnecessarily increases the Company's cost of capital. Therefore, she proposes that the Commission reverse the exchange for regulatory purposes.

11. Twelve witnesses from the general public also appeared and testified at the hearing. There was a general consensus among those who testified that the Company and its shareholders should bear the loss resulting from its misjudgment and not expect to pass it off on the ratepayers. (Tr. pp. 72, 137, 192, 211, 215, 223 and 238.) The position was also expressed that ratepayers should not pay for a bad decision when they had no part in making that decision (Tr. pp. 194, 210) and that a utility's investment should not be made risk-free by allowing them to recover that investment even when it does not produce (Tr. pp. 194, 211).

C. Discussion, Analysis and Conclusions

12. Many issues have been identified through the course of this proceeding. Among them are the following questions: Were the Company's actions in investing in the nuclear projects prudent? Is recovery of those investments allowed under Montana law in view of the fact that the projects will not produce any electricity? Have the Company's investors been compensated for the risk associated with their investment? Over what period should the Company receive a recovery of its investment? How should the Company's investment in the terminated nuclear projects be calculated? How should a carrying charge on the unamortized portion of the investment be

calculated? Should the debt/equity exchange be recognized for regulatory purposes? What would be the Constitutional implications of total disallowance?

13. However the overriding broad issue presented by this case was perhaps best identified by those members of the consuming public who testified when they repeatedly framed the issue as follows: Should ratepayers be required to compensate PP&L for investments made in nuclear projects that will not provide energy to ratepayers due to misjudgment by the Company's management? Or stated even more simply, who should bear the loss; ratepayers or the Company's stockholders?

14. In addressing this broad issue the Commission is governed first as it always is by the ratemaking standards and guidelines established by the Montana legislature. As a creature of the legislature the Commission is compelled to apply general ratemaking principles set forth by the legislature in the statutes, Title 69, Chapter 3, MCA. In this instance the Commission concludes that its legislative direction precludes it from granting the relief requested by the Company.

15. In 69-3-109, MCA, the legislature addressed the Commission as follows:

The commission may, in its discretion, investigate and ascertain the value of the property of every public utility actually used and useful for the convenience of the public. The commission is not bound to accept or use any particular value in determining rates; provided, that if any value is used, such value may not exceed the original cost of the property. (emphasis added)

The Commission can perceive of no legislative purpose in including the phrase "actually used and useful" other than to limit a utility's recovery of investments in property (at least from ratepayers) to those investments in property which are actually used and useful in providing utility service to ratepayers.

16. PP&L does not contend in this case that the investment or property in question (Pebble Springs and WPPSS-5 nuclear projects) will ever be used to provide utility service to its ratepayers. This being the case, the Commission under 69-3-109, MCA, is not in a position to first, place a value on the investment in the terminated projects and second, require ratepayers to compensate PP&L based upon that value.

17. Therefore, the Commission concludes that it must deny all recovery requested in the application based upon Montana statute.

18. PP&L has maintained that 69-3-109, MCA, does not apply in this case because it applies only to rate base determinations and the Company is not seeking rate base treatment of its investments in the terminated projects. The Commission is not swayed by this distinction. It is one of semantics only.

19. Under rate base treatment PP&L would be allowed to totally recover its investment in the projects from ratepayers by being allowed revenues for depreciation over the life of the plants (30 to 40 years) as well as a return on the undepreciated balance. Under the treatment PP&L proposes in this case, the Company would again be allowed to totally recover its investment in the projects from ratepayers by being allowed revenues for amortization over five years as well as a "carrying charge" on the unamortized balance. The "carrying charge" would equal the return on rate base authorized by the Commission in PP&L's most recent general rate case. The only difference to the Company between one scenario where the plants are completed and are used to provide electric service and given rate base treatment and a second scenario where the plants are abandoned and provide no service and are given the treatment proposed by the Company, is that the Company would recover its total investment faster in the second instance. If anything, the Company is better off if the projects fail and have to be terminated than it would be if they are successfully completed and provide service. The disincentives for good management practices if such recovery were allowed are obvious.

20. The intent for including the "actually used and useful" limitation in 69-3-109, MCA, is to avoid requiring ratepayers to compensate utilities for investments which do not benefit ratepayers. PP&L should not be allowed to circumvent that basic intent by simply declaring that its proposal does not constitute "rate base treatment." A rose by any other name is still a rose.

21. PP&L maintains even in the face of 69-3-109, MCA, that it is entitled to recover from ratepayers its investments in the terminated nuclear projects because those investments were prudent. The Commission finds it unnecessary in this proceeding to make any findings with regard to the prudence of PP&L's participation in these projects. This is so because the standard set forth by the

legislature and applied by the Commission is whether the projects are used and useful and not whether PP&L was prudent in participating in them. Had the legislature intended to allow utilities to recover from ratepayers all of their "prudent" investments rather than only those investments that are "actually used and useful" it could easily have substituted "prudency" language for the "used and useful" language in 69-3-109, MCA.

22. Many of the public witnesses at the hearing compared PP&L's plight with that of any other business. That is they could not understand how PP&L could expect the Commission to require the ratepayers to pay for the Company's mistakes, to bail them out, when in any other business a company's shareholders would be forced to absorb the losses associated with its failures. PP&L is quick to point out that as a regulated enterprise it is not on the same footing as nonregulated businesses. The Commission is fully aware that the Company's obligation to serve restricts its activities to a degree not experienced by nonregulated entities. In return, investors in PP&L as a regulated utility experience certain advantages in the regulatory arena which makes their investment less risky than most investments in nonregulated businesses. However, granting of PP&L's proposal in this case would amount to an abuse of that distinction.

23. In return for its obligation to serve all ratepayers in its service area with electricity, PP&L is allowed to provide such service from a monopoly position. This tends to make investment in PP&L less risky than investment in most nonregulated businesses. Allowance of the recovery requested by PP&L in this case would improperly expand that monopoly advantage to a point where the investment would become risk-free or at least be subject to a very limited risk. Under the Company's proposal the only way the shareholder could fail to recover his investment is if the project were both a failure and imprudent. The Commission sees nothing in its statutes that would indicate that the legislature intended that the utility investor's risk should be limited to this degree. Nor has the Commission in determining appropriate rates of return considered utility investors' risks to be so limited.

24. The appropriate standard as selected by the legislature is the "used and useful" standard. The risk that a project will not ultimately provide service to the ratepayer should be borne by the shareholder. It is the shareholder through the management he has selected for the Company

who determines which projects should be pursued, not the ratepayer. To expect the ratepayer to compensate the shareholder for the Company's failures whether prudent or not amounts to providing the shareholder with a guaranteed¹ recovery of his investment. Neither the legislature or this Commission has made such a guarantee.

25. The Company has also attempted to draw a distinction between return of investment and return on investment. Such a distinction serves no purpose in this case. The legislature in adopting the "used and useful" standard has put the utility investor on notice that by choosing to participate in a project he risks not only the possibility that he will not earn a return on his investment but also that he may not recover his initial investment if the project does not become used and useful. To guarantee a recovery of initial investment would require that the Commission modify its thinking in evaluating investor risk associated with investment in utility stocks.

26. Based upon the foregoing analysis the Commission concludes that it would be appropriate for the Commission to apply the used and useful principle even if the legislature had not dictated that it be applied through 69-3-109, MCA. Even if 69-3-109, MCA, did not exist, there is no provision in Title 69, Chapter 3 that would dictate that the Commission apply any standard other than the used and useful principle. In the absence of 69-3-109, MCA, the Commission would nonetheless not allow recovery from the ratepayers in this case based upon exercise of the Commission's discretion after balancing the interests of the utility and the ratepayer. The

¹ This should not be interpreted as meaning a literal guarantee. As with any return allowed by the Commission it would be subject to unforeseen changes during the period rates are in effect. By way of example, a change in which could affect the actual realization of a return would be an abrupt unexpected decrease in consumption leaving the utility with only enough revenue to cover its direct expenses.

Commission concludes that forcing the ratepayers to pay for projects which they had no part in conceiving, which failed through no fault of theirs and which will never benefit them is patently unfair to those ratepayers. On the other hand, requiring the shareholders to bear the loss of projects they indirectly conceived, while still resulting in a hardship for one party, is certainly less unfair.

27. PP&L in its post-hearing brief argues that even if 69-3-109, MCA, is interpreted as precluding recovery of investment that is not used and useful, the Commission is still precluded from a total disallowance of recovery by provisions of the Montana and United States Constitutions. It is the Company's position that total disallowance would constitute a taking of private property for a public use without just compensation. Although the Commission does not normally involve itself in matters of constitutional interpretation, it is prepared to reject the Company's contention in this case based upon a simple reading of the pertinent provisions.

28. Article II, Section 29 of the Montana Constitution states as follows:

Eminent Domain. Private property shall not be taken or damaged for public use without just compensation to the full extent of the loss having been first made to or paid into court for the owner....

The Fifth Amendment to the United States Constitution similarly states:

... nor shall private property be taken for public use without just compensation.

Both constitutional provisions are premised upon a "taking" and "use" of private property. Neither has occurred in this case. PP&L retains full control and use of the projects unrestrained by either the Commission or the ratepayers.

29. While totally disallowing recovery in this case, the Commission is aware that earlier Commissions have issued decisions that are somewhat in conflict. The Company cites in particular the Commission's decision in Docket No. 6517, Order No. 4401a relative to its abandonment of the High Mountain Sheep Project. To the extent that any prior decisions are in conflict, this decision should be considered controlling on the issue. Not until this case has the Commission embarked upon such a thorough and intensive examination of the used and useful principle and the rationale behind it. The efforts of the Commission and the parties to fully explore all of the ramifications of

abandonment of projects greatly exceeds any that have heretofore been expended. This entire docket was dedicated to that end. The Commission does not accept the proposition that it is precluded from issuing a decision modifying earlier stances on the same issue now that such issue has been more fully examined.

30. The Commission is also cognizant that by issuing a decision disallowing any recovery, it has not accepted the position of either of the principle parties to this case. However, it must be remembered that the Montana Consumer Counsel's position was predicated on an assumption that Montana law allows some form of recovery from ratepayers. Given the Commission's interpretation of 69-3-109, MCA, that assumption is not operative and therefore the Consumer Counsel can be viewed as not having a position in this case relative to recovery of investment.

31. By applying the used and useful principle in 69-3-109, MCA, and thereby disallowing recovery, the Commission has rendered moot many of the issues identified in Finding No. 12. There remains however the question of how to treat the gain on the debt/equity exchange for ratemaking purposes. The Commission concludes that the exchange should be reversed for regulatory purposes. Future ratemaking proceedings should be conducted as if the exchange never took place.

32. In June of 1982, PP&L reacquired \$131,988,000 of existing first mortgage and pollution control bonds in exchange for the issuance of \$2,846,428 shares of preferred stock. Upon retirement of the debt, PP&L realized a \$55,153,000 paper gain resulting from the exchange. The Commission did authorize PP&L in Docket No. 82.4.26, Order No. 4905 to issue preferred stock with the knowledge that it would probably be used to reacquire Company debt. However, the Commission made no determinations regarding ratemaking treatment at that time and specifically reserved such a determination until a later appropriate proceeding (Order No. 4905, Finding No. 16). PP&L takes the position that if the gain is not applied to amortization of the WPPSS-5 project termination loss, the gain should be restored to income over the life of the debt instruments that were retired.

33. The exchange results in a higher cost of capital due to a decreased debt ratio, increase in the weighted cost of debt, an increase in the preferred stock ratio, and an increase in the embedded

cost of preferred stock. By the same token, the exchange should result in an offsetting benefit by reducing the cost of all forms of new capital due to an increase in the equity ratio. The Commission agrees with Montana Consumer Counsel witness Dr. Caroline Smith that the best way to determine if the net result is a benefit to ratepayers is to compare the cost of capital before and after the exchange while at the same time quantifying any benefits associated with an increased equity ratio.

34. Dr. Smith considered the cost of capital under three scenarios: Without the exchange (Exh. CMS-2) with the exchange (Exh. CMS-3) and with the exchange applying the FERC method of treatment. The lowest revenue requirement occurs if the exchange does not take place. Ratepayers are entitled to receive service at the lowest possible cost. Therefore, in future rate proceedings revenue requirements should be calculated as if the exchange had not taken place.

35. In summary, the Commission interprets 69-3-109, MCA, as precluding recovery from ratepayers of investments in projects which are not used and useful. Application of the used and useful principle is appropriate in any event. Because the Pebble Springs and WPPSS-5 projects are not used and useful in providing electric service to ratepayers, those ratepayers should not be required to pay the losses associated with the termination and abandonment of those projects. The recently completed debt/equity exchange should not be recognized for ratemaking purposes.

CONCLUSIONS OF LAW

1. Pacific Power and Light Company provides electric service to electric consumers in Northwestern Montana and as such is a "public utility" within the meaning of 69-3-101, MCA.

2. The Montana Public Service Commission properly exercises jurisdiction over the Company's application to recover from ratepayers losses associated with participation in abandoned nuclear generating projects.

3. Section 69-3-109, MCA, precludes recovery from ratepayers of utility investments in projects if those same projects are not used and useful in providing utility service to the ratepayers.

ORDER

THE MONTANA PUBLIC SERVICE COMMISSION ORDERS THAT:

1. Pacific Power and Light Company's application to increase rates to generate revenues to recover costs associated with the Pebble Springs and WPPSS-5 terminated nuclear generating projects is DENIED in total.

2. The debt/equity exchange completed by Pacific Power and Light Company in June of 1982 will not be recognized by this Commission for ratemaking purposes.

DONE AND DATED this 18th day of April, 1983 by a vote of 5-0.

BY ORDER OF THE MONTANA PUBLIC SERVICE COMMISSION.

THOMAS J. SCHNEIDER, Chairman

JOHN B. DRISCOLL, Commissioner

HOWARD L. ELLIS, Commissioner

CLYDE JARVIS, Commissioner

DANNY OBERG, Commissioner

ATTEST:

Madeline L . Cottrill
Secretary

(SEAL)

NOTE: Any interested party may request the Commission to reconsider this decision. A motion to reconsider must be filed within ten days. See 38.2.4806, ARM.