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STATE COMMISSION TREATMENT OF NUCLEAR PLANT CANCELLATION COSTS

Paul Rodgers and Charles D. Gray*

INTRODUCTION

In its February 11, 1985 cover story, Forbes magazine sounded its death-knell for the nuclear power industry in the United States. The author noted that the nation’s electric utilities had cancelled seventy-five nuclear power plants since 1978, including twenty-eight plants in various stages of construction, and concluded that “[t]he failure of the U.S. nuclear power program ranks as the largest managerial disaster in business history, a disaster on a monumental scale.”1 While opinions differ regarding the magnitude of this “disaster” and where to place the blame,2 there is no doubt that the nation’s ambitious nuclear generating program accumulated huge debts that the United States will be paying for decades.3 The costs of nu-

* Mr. Rodgers and Mr. Gray are, respectively, General Counsel and Assistant General Counsel of the National Association of Regulatory Utility Commissioners. Any views and opinions expressed in this Article are solely those of the authors, and should not be attributed to the National Association of Regulatory Utility Commissioners or its members.

2. Commentators cite various factors leading to substantial cost overruns on nuclear power projects, including inflation, two Arab oil embargoes and the resulting slowdown in industrial growth, irresponsibility on the part of regulators, incompetence of utility management and nuclear contractors, and the anti-nuclear activities of protest groups, environmentalists, and consumer advocates. See id. at 83-84; Wechsler, Nuclear Power: Who Fots the Bill?, DUN’S BUS. MONTH, June 1984, at 70-71.
3. See Cook, supra note 1, at 84. It is estimated that the electric utility industry has already invested $125 billion in nuclear power, and that another $140 billion will be invested before 1990. Id. at cover. Cost overruns add an estimated $100 billion in interest and other
clear plants that utilities were able to complete, often at great expense, are straining the finances of utilities in virtually every region of the country. The cost impact of these completed plants is felt by utility ratepayers, investors, and taxpayers. As additional high-cost plants are completed, controversy over the allocation of their costs will likely escalate. Another group of costs, however, is even more controversial: costs incurred by utilities in constructing plants that will never generate one kilowatt hour of electricity because the plants have been abandoned.

In the early to mid-1970's, many electric utilities decided that new power plants were needed in order to provide sufficient generating capacity to meet future demand for power from consumers. Based upon demand forecasts and the expected costs of different types of construction, these utilities chose to build and operate one or more nuclear generating stations that were expected to be in service in the late 1970's and early 1980's. Certain intervening events, including the two Arab oil embargoes, endemic inflationary forces in the economy, and the “event” at Three Mile Island in March, 1979, expenses to the nation’s electric bill. Wechsler, supra note 2, at 70.

4. For example, six major utilities, including the Long Island Lighting Co., Public Service of New Hampshire, Consumers Power in Michigan, and Public Service of Indiana, are under such extreme financial pressure as a result of cost overruns and abandonments of nuclear projects that they “are in serious danger of going into bankruptcy.” Cook, supra note 1, at 83. See Wechsler, supra note 2, at 71-73.

5. Utility shareholders and bondholders have already begun to pay for the substantial cost overruns and cancellations of nuclear power plants. Dividends have been cut or suspended by a number of utilities, while the market value of utility stocks has fallen, in some cases dramatically. Wechsler, supra note 2, at 72. In July, 1983, Washington Public Power Supply System defaulted on $2.2 billion in bonds. Cook, supra note 1, at 96. It is estimated that taxpayers will ultimately foot the bill for up to 42% of these costs over the next ten years, as a result of write-offs by utilities and their shareholders and deferred taxes and depreciation on plants. Wechsler, supra note 2, at 73. Likewise, ratepayers are paying these costs in the form of higher rates. Cook, supra note 1, at 83. In addition, some utilities and regulatory commissions are faced with the prospect of “rate shock” as a result of the addition of these costly plants to rate base. Id. at 94.

6. In the late 1960's, utilities were faced with annual industrial growth of seven to eight percent — a rate that would require “the doubling of electric generating capacity every ten years.” Wechsler, supra note 2, at 70. See Cook, supra note 1, at 88.


8. See Cook, supra note 1, at 88-89; Wechsler, supra note 2, at 70-71. Of all the problems facing the nuclear power industry in the 1970's, perhaps none was more damaging than the accident at Three Mile Island (TMI), on March 28, 1979. At TMI, a stuck valve and mistakes by operating personnel caused the nuclear reactor to overheat dangerously. Cook, supra note 1, at 88. As a result, the reactor core was damaged and radioactive gases were
led utility management to reassess construction plans and, as a result, to cancel planned nuclear plants. At first, the utilities cancelled so-called "paper plants" — plants for which actual construction had not commenced. Beginning in 1980, however, utilities began to cancel nuclear plants already under construction.

State and federal regulatory commissions are confronted with the question of how to allocate the costs associated with cancelled nuclear power plants. Publicly-owned utilities present different allocation options than utilities that are privately-owned. Publicly-owned utilities raise capital for new plant construction by issuing bonds. The abandonment costs of their cancelled nuclear plants must be recovered from ratepayers, unless these utilities default on their bonds. Since a default would have a prohibitive effect on the ability of these utilities to raise capital in the future, ratepayers are seen as the only available group to bear these costs. In the case of privately-owned utilities, however, costs can be allocated among three groups: ratepayers, investors, and taxpayers.

This Article will provide an overview of state regulatory com-

9. The Energy Information Administration (EIA) reports that, of the 120 nuclear units ordered in the ten-year period between 1972 and 1982, 100 have been cancelled. The EIA study defines a nuclear plant cancellation as having occurred when a utility orders a nuclear steam supply system for a plant from a vendor and later cancels it. EIA REPORT, supra note 7, at 4-5.

There are many reasons why utilities decide to cancel planned nuclear generating plants. The EIA has outlined five basic factors that lead to plant cancellations: (1) lower forecasted load growth as a result of higher rates, consumer conservation, and slower industrial growth; (2) constraints on the utility's ability to raise construction capital at affordable rates; (3) safety-related changes in regulatory requirements for plant construction that increase costs; (4) changes in plant economies that cause utilities to substitute other forms of generation for nuclear; and (5) decisions in some states to deny certificates to plants still in the planning stages. Id. at 4-32.

10. Id. at 4.

11. Id. at 4, 6.

12. Id. at 38; see id. at 19. But see supra note 5 (Washington Public Power Supply System default).

13. Id. at 38. See infra notes 55-72 and accompanying text. Of the 100 nuclear reactors cancelled between 1972 and 1982, 88 were being built by privately-owned utilities. EIA REPORT, supra note 7, at 17. The issue of how taxpayers are affected by the cost allocation decision is beyond the scope of this Article.
mission ratemaking decisions, issued over the last five years, allocating the costs of nuclear plants cancelled by investor-owned electric utilities.

I. THE ROLE OF INDEPENDENT REGULATORY COMMISSIONS

The absence of competition in electric utility service areas led states to establish independent regulatory commissions to oversee utility activities and to protect the interests of the public.\textsuperscript{14} The primary duty of such commissions is to ensure adequate service to the public at minimum cost, while providing a reasonable return for investors.\textsuperscript{15}

Regulatory commissions draw their authority from statutes enacted by the states or the federal government.\textsuperscript{16} Although often called independent,\textsuperscript{17} state and federal regulatory commissions are generally creatures of their respective legislatures, having only those powers granted by enabling legislation.\textsuperscript{18} Commissions are usually granted authority in general terms, but legislation may restrict a commission’s discretion with regard to specific issues.\textsuperscript{19}

Each state has a regulatory commission to oversee the activities of utilities.\textsuperscript{20} Regulatory powers of commissions vary from state to state.\textsuperscript{21} Generally, however, they include the authority to: (1) issue licenses, franchises, or permits for the initiation of service and for the construction or abandonment of facilities; (2) approve rate changes; (3) control the quantity and quality of service provided; and (4) prescribe uniform systems of accounts.\textsuperscript{22}

\textsuperscript{15} Id. at 62.
\textsuperscript{17} Theoretically, these commissions enjoy a high degree of independence from the other branches of government. The commissions are bipartisan in nature, with no more than a simple majority having the same political affiliation. Commissioners serve lengthy terms in office, usually four to ten years, and removing commissioners from office is extremely difficult. Independence from the political branches of government, continuity, expertise, flexibility, and impartiality are commonly cited as advantages of utility regulation by commission. See K. Howe & E. Rasmussen, supra note 14, at 150-51; C.F. Phillips, Jr., supra note 16, at 132-33.
\textsuperscript{18} C.F. Phillips, Jr., supra note 16, at 136.
\textsuperscript{19} See infra notes 108-30 and accompanying text.
\textsuperscript{20} K. Howe & E. Rasmussen, supra note 14, at 149, 155-56; C.F. Phillips, Jr., supra note 16, at 117. Note, however, that the Nebraska Public Service Commission does not have jurisdiction over electric utilities. See id. at 118.
\textsuperscript{21} C.F. Phillips, Jr., supra note 16, at 117.
\textsuperscript{22} Id. In some states, utilities are required to obtain a certificate of public convenience and necessity from the state regulatory commission before beginning construction on a new
In addition to state regulation of electric utilities, the Federal Energy Regulatory Commission (FERC) is charged with regulating the sale of electric energy for resale and the transmission of electric energy in interstate commerce. These activities are subject to FERC jurisdiction rather than the jurisdiction of the various state regulatory commissions.

A. Rate Determination

Regulatory commissions devote most of their time and energy to the task of rate regulation. Rate determination is essentially a two-step process. First, the commission must determine the utility’s “revenue requirement” — the amount of revenue to which the utility is entitled for providing service to the public. Second, the commission must devise a rate structure establishing the prices to be charged to the various segments of the public that receive service.

The utility's revenue requirement is determined by calculating its cost of service. The utility’s cost of service is the sum of its operating expenses, taxes, and the return allowed investors on the “rate base.” The rate base is composed primarily of the utility’s plant. Such a certificate is issued if the commission finds that the proposed plant is necessary, i.e., needed to meet future demand. The requirement that utilities obtain a certificate of public convenience and necessity for construction of new plant and facilities is basic to public regulation of monopoly service-providers. The purpose of the certificate requirement is to compel the applicant-utility to demonstrate its projected ability to continue to provide adequate and reliable service at just and reasonable rates. Id. at 475. In some states, however, the regulatory commission need not grant prior approval of new plant construction. These states adhere to the belief that such a decision is best made by utility management. Pierce, The Regulatory Treatment of Mistakes in Retrospect: Cancelled Plants and Excess Capacity, 132 U. Pa. L. Rev. 497, 532 (1984).

Construction of nuclear power plants must also be licensed by the Nuclear Regulatory Commission (NRC). The NRC was established in 1974, when the Atomic Energy Commission (AEC) was abolished, and assumed the AEC's duties of licensing and regulating civilian use of nuclear energy. C.F. Phillips, Jr., supra note 16, at 127.


24. Concurrent jurisdiction in the area of utility regulation led to jurisdictional conflicts between state and federal regulatory commissions. Congress attempted to alleviate these problems by explicitly outlining the extent of federal authority in legislation. See C.F. Phillips, Jr., supra note 16, at 142-46.


27. K. Howe & E. Rasmussen, supra note 14, at 63. See R. Morin, supra note 26, at 5. Typical customer classes for electric utilities are residential, commercial, and industrial. K. Howe & E. Rasmussen, supra note 14, at 111.

28. K. Howe & E. Rasmussen, supra note 14, at 64; R. Morin, supra note 26, at 5.

29. K. Howe & E. Rasmussen, supra note 14, at 64-65; R. Morin, supra note 26, at 5.
investment in plant service. The formula used for determining the utility's revenue requirement can be expressed as follows: $RR = O + T + (V - D)R$, where $RR$ represents the revenue requirement; $O$, the operating expenses and annual depreciation; $T$, the annual taxes; $V$, the value of the utility plant; $D$, the accumulated depreciation; and $R$, the allowed rate of return. The expression $(V - D)$ represents the rate base.

Procedures used for determining rates vary among commissions. Generally, a commission will select a recent "test" year and examine the revenues, costs, and rate base of the test period. Only reasonable and ordinary costs are considered in ratemaking; imprudent or unnecessary costs and costs associated with illegal activities are not considered. Extraordinary revenues and costs incurred in the test year are "normalized." During the ratemaking process, rate base also includes investment for working capital and certain plant held for future use. The AFUDC is the utility's cost of capital used to finance construction of the plant and other overhead construction costs. Id. at 92; C.F. Phillips, Jr., supra note 16, at 322-23. AFUDC is determined by imputing an interest charge to the funds a utility has invested in construction of a new project, based on the utility's average cost of capital. That amount is then capitalized, i.e., treated as part of the plant's total cost to be included in rate base, and is recovered from ratepayers. In addition, AFUDC also appears as a non-cash credit on the utility's income statement. Thus, AFUDC increases both the utility's reported net income and the cost of the project. Cook, supra note 1, at 94.

Problems developed as a result of this accounting treatment of AFUDC, due to the rising costs of capital and construction, and lengthy construction periods for new plants. The AFUDC accounts of utilities became extremely large. As a result, since the pay-out ratio of a utility is very high (usually over 50%), utilities were forced to borrow funds to pay dividends on paper earnings. The resulting cash flow problems led many commissions to allow all or part of construction work in progress (CWIP) to be included in rate base. The circumstances under which commissions allow CWIP in rate base, and the amounts allowed, vary widely among jurisdictions. C.F. Phillips, Jr., supra note 16, at 323-25. Inclusion of CWIP in rate base may lead to the inclusion of plant that is not used and useful. Thus, many jurisdictions do not include CWIP in rate base. K. Howe & E. Rasmussen, supra note 14, at 92.

30. K. Howe & E. Rasmussen, supra note 14, at 88. See R. Morin, supra note 26, at 5. Rate base also includes investment for working capital and certain plant held for future use. K. Howe & E. Rasmussen, supra note 14, at 88. Another important item included in rate base is the allowance for funds used during construction (AFUDC). The AFUDC is the utility's cost of capital used to finance construction of the plant and other overhead construction costs. Id. at 92; C.F. Phillips, Jr., supra note 16, at 322-23. AFUDC is determined by imputing an interest charge to the funds a utility has invested in construction of a new project, based on the utility's average cost of capital. That amount is then capitalized, i.e., treated as part of the plant's total cost to be included in rate base, and is recovered from ratepayers. In addition, AFUDC also appears as a non-cash credit on the utility's income statement. Thus, AFUDC increases both the utility's reported net income and the cost of the project. Cook, supra note 1, at 94.

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33. Id. at 63.

34. Id. at 63, 70. See R. Morin, supra note 26, at 5. Not all utilities use historical test year data in ratemaking. In recent years, some commissions have begun to use "forecast" or "forward" test year data in order to cope with the problem of rapid inflation. Use of historical test periods is still the prevalent practice, however. See K. Howe & E. Rasmussen, supra note 14, at 71; R. Morin, supra note 26, at 5.


36. Id.

37. Id. at 75.
commissions adjust test year data as changes in utility costs become known or are more accurately anticipated. The commission compares the revenue earned by the utility in the test year with the revenue requirement as determined above, and adjusts the rate structure to generate the required revenue. These rates remain in effect until the commission decides that changes need to be made.

Although the rate determination theory and equation seem simple to understand, ratemaking is a difficult task because of the controversies and problems involved in determining the values to be assigned to the equation's component parts. For purposes of allocating nuclear plant cancellation costs, the crucial variable in the rate determination equation is rate base. Investment and cancellation costs of abandoned nuclear plants are designated as extraordinary property losses on the utility's books. Such costs are allocated to ratepayers when utilities are allowed to amortize these losses as a charge against income over a reasonable number of years. Thus, they are recovered by the utility as a cost of service. Utility shareholders also share in these losses if they forgo a return on the unamortized balance of these costs, i.e., if the unamortized balance of these costs is excluded from rate base and the regulatory commission disallows any carrying charges on the unamortized balance. The crucial questions in allocating nuclear plant cancellation costs for an investor-owned utility are whether the principal payments will be recovered through amortization and whether the unamortized balance of these costs should be included in rate base.

B. The Cost Allocation Decision

Two tests have traditionally been used by commissions for determining whether or not a utility's investment in new plant should be included in rate base: the prudent investment test and the used and useful test. Under the prudent investment test, if a utility

38. See id. at 74; R. MORIN, supra note 26, at 5.
40. Id.
41. Id. at 65. A discussion of the numerous issues and controversies involved in giving numerical values to all the variables in the rate determination equation is beyond the scope of this Article. For an exhaustive treatment of the subject, see id. at 76-109.
43. See id.
44. See id.
45. See id. at 364-65.
46. Pierce, supra note 22, at 511.
makes an investment that is imprudent in light of information that was reasonably available to management at the time the investment decision was made, all costs associated with that decision are disallowed in determining rates. It is rare for a commission to disallow all or a substantial part of a utility's investment as imprudent.

A second test for determining whether utility investment in plant construction can be included in the rate base is the used and useful test. Under this test, only the costs of plants that are actually used and useful to the utility in providing service are included in the rate base. The used and useful test excludes from rate base plants that are not yet providing service, and also requires the removal of undepreciated capital costs from rate base where plants are no longer used due to obsolescence. While these two tests are most often used by commissions for determining rate base treatment of operating plant, they are also used to calculate the rate base treatment of abandoned plant.

The costs associated with nuclear plant cancellation fall into four categories: (1) the direct cash payments the utility has made up to the time of abandonment for land, site improvements, labor, materials, engineering and environmental studies, and licenses and permits; (2) the costs incurred by the utility to raise the capital necessary to construct the plant, often called allowance for funds used during construction (AFUDC); (3) any contract cancellation penalties; and (4) costs incurred in discontinuing construction, minus salvage value.

A number of cost allocation options are available to regulatory commissions in the case of an investor-owned utility. From a ratepayer's perspective, these options can be grouped into three categories. First, the commission can allow all the cancellation costs to be

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47. Id.
48. Id. at 511-12, 512 n.78. But see Cook, supra note 1, at 89 (the New York Public Service Commission proposes disallowance of $1.9 billion of the Shoreham plant's $4.2 billion in construction costs).
49. Pierce, supra note 22, at 512.
50. Id.
51. Id. at 512-13. Note, however, that the used and useful test will not necessarily exclude CWIP from rate base. See C.F. Phillips, Jr., supra note 16, at 324 n.153.
52. See Pierce, supra note 22, at 517.
53. See supra note 30.
54. EIA REPORT, supra note 7, at 33, 37-38. Salvage value is the amount the utility will realize from the sale of the site materials, equipment, and land. Id. at 37-38.
55. EIA REPORT, supra note 7, at 39.
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recouped from ratepayers through future rate increases.56 Thus, investors are allowed to earn a return on the entire unamortized balance of the cancellation costs.57 Taxpayers also benefit from this cost allocation option since taxes must be paid on the earned return.58

Second, the commission can completely disallow the costs of the abandoned plant for ratemaking purposes.59 This option forces utility investors and taxpayers to absorb the entire cost.60 No recovery is allowed from ratepayers.61 Under this option, the utility will write off the costs of the abandoned plant as an extraordinary loss in the year of cancellation.62 The share of the costs borne by investors is reduced by the amount of tax savings generated by the write-off.63 Thus, under this option, the cancellation costs are actually shared between investors and taxpayers.

Third, cancellation costs can be shared among all three groups — ratepayers, investors, and taxpayers.64 This option allows only a partial recovery of cancellation costs from ratepayers. This is the most complex of the cost allocation methods and has many variations.65 The distinguishing features of each variation are the degree of return on the unamortized balance of cancellation costs allowed investors, the portion of cancellation costs recoverable from ratepayers and the length of the amortization period.66 The most common variation is to allow amortization of all the cancellation costs over a period of one to twenty years, while not allowing any return to investors on the unamortized balance on the grounds that the abandoned plant will never be used and useful.67 The longer the amortization period, the greater the portion of the abandonment costs borne by the investors since they forgo a return on the unamortized balance of these costs during that period.68 This option thus allocates the burden of cancellation costs among ratepayers, investors, and taxpayers.

56. Id.
57. Id.
58. Id.
59. Id. at 40.
60. Id.
61. Id.
62. Id.
63. Id.
64. Id.
65. Id.
66. See id. at 40-43.
67. Id. at 40-41.
68. Id. at 41.
taxpayers.  

Other variations of the partial recovery method of cost allocation preclude investors from earning a return on all or a portion of the unamortized balance of cancellation costs, while disallowing recovery of all or a portion of these costs from ratepayers, thus shifting the burden of cancellation costs among the three groups.

The remainder of this Article will survey some representative cases and some of the factors, including state legislation, that have influenced the cost allocation decision.

II. STATE CANCELLATION POLICIES

A recent survey by the National Association of Regulatory Utility Commissioners (NARUC) paints a general picture of state cancellation policies. Most state commissions reported that they permit utilities to recover some or all of their cancellation costs from ratepayers, and only a handful completely disallow such cost recovery.

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69. For a detailed explanation of the taxpayer's share of the cancellation costs under this cost allocation option see id. at 41-43.

70. See id. at 42-43. The EIA lists five other variations of the partial recovery option.

71. Option 3 in the EIA REPORT precludes investors from earning a return on the portion of the unamortized balance attributed to common equity financing, while option 2 precludes a return on the portion attributed to both common and preferred equity financing. Id. at 40, 42-43.

72. Option 4 in the EIA REPORT provides that the portion of AFUDC attributed to common equity financing is not recoverable from ratepayers, and that no return is allowed on the unamortized balance of cancellation costs. Option 5 provides that the portion of AFUDC attributed to common equity financing is not recoverable from ratepayers, and that a return is allowed investors only on the portion of the unamortized balance of cancellation costs not attributed to AFUDC. Option 6 provides no recovery of AFUDC from ratepayers and no return on the unamortized balance of cancellation costs attributed to AFUDC. Of the six options listed in the EIA REPORT, option 6 places the greatest burden on investors. Id. at 40-43.

73. Nat'l Ass'n of Regulatory Util. Com'n's, 1984 ANNUAL REPORT ON UTILITY AND CARRIER REGULATION 591-92 (1985) [hereinafter cited as 1984 ANNUAL REPORT]. The survey was originally published in Public Utilities Fortnightly, March 31, 1983. NARUC republishes and updates this survey on an annual basis by soliciting the views of its members, the state regulatory commissions. The most recent NARUC survey reflects state policies through January 1, 1985.

In addition to the NARUC surveys, the Edison Electric Institute has issued periodic reports on nuclear plant cancellation issues. Edison Elec. Inst., REGULATORY TREATMENT OF CANCELLED PLANTS, SURVEY UPDATE OF CASES IN 1983 (Mar. 1984).

74. 1984 ANNUAL REPORT, supra note 73, at 591-92. Thirty-five state commissions responded to the most recent NARUC survey. Twenty-nine reported that they permitted utilities to recover some or all of their cancellation costs from ratepayers; six reported complete disallowance of cost recovery. The six were Arizona, Iowa, Montana, New Hampshire, Georgia and Ohio. Id.

The NARUC survey also revealed that twenty-six state commissions had directed that
Thus, utilities are most often able to add up their recoverable costs, amortize these costs over a period of years and collect, as an expense item in each year, their share of the costs on a straight-line basis. However, only a few of the state commissions allowing cost recovery permit utilities to add some or all of the unamortized balance of costs to their rate bases.

A. State Commission Decisions to Permit Cost Recovery: The Balancing of Interests

The allocation of plant cancellation costs requires an equitable balancing of investor and ratepayer interests. The state commissions permitting recovery of abandonment costs have resorted to various methods in their attempts to achieve this balance. The individual variations in each case typically concern the types of costs which are recoverable, the length of the amortization period, and the degree of managerial prudence required in the construction and cancellation decisions. Frequently, all of these factors come into

utilities amortize their abandonment costs over a period of years. Eleven of these twenty-six states chose a ten-year amortization period in at least one cancellation case. Id.

75. A simple example: a utility cancels a nuclear construction project in which it has invested $50 million in recoverable costs. Under the majority practice, the utility is permitted to recover $5 million per year for ten years from its ratepayers as a return of capital. At no time, however, may the utility add any of the $50 million to its rate base. The utility is thereby precluded from earning a return on its capital investment. See supra notes 43-45 and accompanying text.

76. 1984 ANNUAL REPORT, supra note 73, at 591-92. Four states reported that they had permitted utilities to add some or all of the unamortized balance of costs to the rate base. The four were Florida, Oklahoma, New York and Vermont. Id.


79. Focusing on the appropriate amortization period highlights the inherent conflict between the goals of minimizing the cost impact on consumers, and preserving the financial health of the utility. The impact on consumers decreases as the period of amortization increases, by allowing the costs to be spread out over a longer period of time; conversely, the financial health of the utility improves with a shorter amortization period.

80. The prudence inquiry is a fact-laden exercise in which a commission assesses, among other issues, the reasonableness of the utility's demand forecasts, its choice of competing technologies, and the economic basis of the nuclear option ultimately chosen. The timing of the
play simultaneously.

For example, in *In re Boston Edison Co.*, the Massachusetts Department of Public Utilities (MDPU) made a cost allocation decision based on three basic principles: (1) the prudence of the utility's actions; (2) the fairness of any proposed allocation; and (3) the need to adjust the financial impact of any allocation to ensure the adequacy of future service. The case concerned the abandoned Pilgrim II nuclear power plant.

On the issue of managerial prudence, the MDPU found that the utility's decision to begin construction of the plant was prudent, but that it was imprudent for the utility to postpone its cancellation decision as long as it did. Stating that a standard of perfection is unrealistic, the MDPU based its findings on "how reasonable individuals would have responded to the particular circumstances and whether the company's actions were prudent in light of all conditions and circumstances which were known or which reasonably should have been known at the time the decisions were made."

A combination of factors had led Boston Edison to put Pilgrim II on hold in June, 1980. These factors included uncertainty as to when or if a construction permit could be procured, extension of the project's duration, increased cost estimates and, consequently, the evaporation of the value of a 500 million dollar loan. The utility ultimately cancelled the project in September, 1982. The MDPU, however, found that the risks associated with Pilgrim II had become intolerably high by June, 1980, and that this should have led the utility to cancel the project instead of putting it on hold.

The MDPU therefore held that Boston Edison could recover costs incurred before July 1, 1980, but, based on its prior practice, the eq-
uity component of AFUDC would be excluded from amortizable costs. Based upon the assessment of risks to shareholders and ratepayers, the need to maintain stable rate levels and the utility's current and future need to raise capital, the MDPU ordered that the recoverable costs be amortized over a period of thirteen years without addition of unamortized amounts to the rate base.

In 1982, the MDPU reviewed a request by another utility to recover its Pilgrim II cancellation costs. In *In re Commonwealth Electric Co.*, the MDPU relied heavily on its decision in *Boston Edison*. In fact, the MDPU imputed Boston Edison's managerial imprudence in failing to cancel the project in June, 1980 to Commonwealth Electric. Like Boston Edison, Commonwealth Electric was permitted to recover its share of the cancellation costs incurred prior to July 1, 1980, excluding the common equity component of AFUDC. However, because Commonwealth Electric's costs were significantly lower, a two-year amortization schedule was found to be appropriate.

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88. *Id.* at 471-72. *See supra* note 75. By addressing recovery of AFUDC, the Commission, in effect, removed from recoverable costs those costs incurred by the utility in raising common equity capital to construct the plant. *See supra* note 30. By disallowing equity components of AFUDC, the Commission denied shareholders any return during the construction period.

Boston Edison Co. had incurred cancellation costs totaling $278 million. *46 P.U.R.4th* at 471. The exclusion of costs incurred after June, 1980 and the equity component of AFUDC, left a total of $204 million to be recovered through rates. *Id.* at 474.

89. *Id.* at 471-73. By denying rate base treatment, the Commission disallowed shareholder profits in the future. However, the MDPU did authorize Boston Edison to recover carrying costs on the unamortized amounts at a rate of 14%. *Id.* at 472. The MDPU also directed that the utility subtract $85 million in tax benefits attributable to the cancellation costs, which ultimately gave Boston Edison an annual amortization of $12.7 million. *Id.* at 474.

90. *47 P.U.R.4th* 229 (Mass. Dep't Pub. Util. 1982). Unlike Boston Edison, the lead participant in the Pilgrim II project, Commonwealth Electric had minimal exposure to the cancellation costs. The utility requested recovery of only $7.2 million. *Id.* at 234.

91. *47 P.U.R.4th* at 235. The MDPU stated: "[W]e impute [this liability to Commonwealth Electric] on what we consider to be sound legal and policy grounds. . . . [A]ll participants, and thus their respective ratepayers and investors, should be treated uniformly, and not differently, by their regulators." *Id.*

The MDPU took special note of the agreement entered into by the utilities participating in the Pilgrim II project. The agreement provided for joint ownership, construction and operation of Pilgrim II, with each participant giving a broad grant of authority to Boston Edison, the lead participant. The agreement discussed the possibility of termination of the project. In such an event, it was agreed that the costs would be shared in proportion to each participant's ownership percentage. *Id.* at 235-36.

92. *Id.* at 236-37.

93. *Id.* at 237. After excluding costs incurred after July 1, 1980 and the common equity component of AFUDC, Commonwealth Electric had a total of $3.1 million in recoverable costs which could be amortized over two years with no carrying charges for the unamortized
Another variable that state commissions take into account is the treatment of unamortized costs. For example, in two decisions concerning Harris Units 3 and 4, the North Carolina Utilities Commission grappled with the issue of whether a utility should be allowed a return on unamortized balances through additions to rate base. Its first decision, *In re Carolina Power & Light Co.*, permitted that portion of the utility's unamortized balance which was supported by long-term debt to be included in rate base. One year later, the Commission modified its order to disallow any rate base treatment of the utility's unamortized balances. The Commission, foreseeing that it would continue to be confronted with the problem in the future, undertook this reexamination "in order to develop a more consistent and equitable approach." The Commission concluded that the most equitable way to allocate these losses between the utility and the consumer was to exclude any portion of the unamortized balance from rate base treatment. This would represent the "middle ground," in which shareholders would receive a return on capital invested in cancelled plant, while ratepayers would not be forced to provide a profit on the investment.

The previous cases are examples of various state commissions considering cancellation questions in utility-specific proceedings. In amounts. *Id.* at 236-37.


95. *Id.* at 216-20.
97. *Id.* at 600.
98. *Id.* at 601.
99. *Id.* at 601. The Commission concluded:
It would be inequitable to place the entire loss of expenditures that were prudent when made on the utility. . . . [O]n the other hand, the ratepayer must not bear the entire risk of the company's investment. A middle ground must be found on which the company bears some of the risk of abandonment and the ratepayer is protected from unreasonably high rates. *Id.*

In re Rochester Gas & Electric Corp.,\textsuperscript{101} however, the New York Public Service Commission used a plant-specific approach when it treated, simultaneously, the cancellation costs incurred by four utilities in the Sterling plant.\textsuperscript{102} Guided by general ratemaking and accounting principles, the impact of cost recovery on consumers and the financial condition of each utility, the Commission established a separate amortization schedule for each of the Sterling utilities.\textsuperscript{103} The individual determinations depended on each utility's relative exposure to the cancellation costs and how the costs incurred compared to the utility's total revenues.\textsuperscript{104} Each utility was also permitted to recover carrying charges on its share of the unamortized balances to be computed on the basis of each utility's overall cost of capital.\textsuperscript{105} The decision in In re Rochester Gas & Electric Corp. illustrates that even when a plant-specific approach is employed, the actual decision-making will depend on utility-specific consideration of all the factors involved in the cancellation decision and the nature and magnitude of the cancellation costs.

B. The Impact of State Legislation

Several state courts and commissions based cost allocation decisions on local statutes regulating public utilities and the ratemaking

\textsuperscript{102} Id. at 387. The four utilities involved were Rochester Gas and Electric Corp., Orange and Rockland Utilities, Inc., Central Hudson Gas and Electric Corp., and Niagara Mohawk Power Corp. All were parties to the proceeding. Id. In the interest of expeditiously resolving the matter, the Commission rejected the normal procedure of deferring the cost recovery question until each utility's next rate case. Id. at 410-11.
\textsuperscript{103} 45 P.U.R.4th at 408-10. The Commission stated that the amortization periods need not correspond to the projected 30-year useful life of the Sterling plant. It reasoned that a long amortization would ultimately increase ratepayer contributions, increase investor risk and, consequently, the cost of future capital. Id. at 408. See supra note 79.
\textsuperscript{104} 45 P.U.R.4th at 408-10. For example, Niagara Mohawk was granted a three-year amortization period due to the small impact its share of the costs would have on its rates and its financial condition. Central Hudson, due to its relatively large stake in Sterling and the need to maintain its financial integrity, was granted a five-year amortization period. Orange and Rockland, deemed to be financially strongest of the four utilities, was assigned a ten-year amortization period in order to minimize rate impact. Rochester Gas and Electric, despite being the most deeply involved in the project, was granted a five-year amortization period in order to provide sufficient cash flow for the utility to meet its “ambitious construction program.” 45 P.U.R.4th at 410.
\textsuperscript{105} Id. at 410-11. The New York Public Service Commission later reported to NARUC that permitting a utility to recover carrying charges on unamortized balances at its overall cost of capital is functionally equivalent to allowing rate base treatment for these balances. See 1984 ANNUAL REPORT, supra note 73, at 582-83. See also In re Financing Plans for N.Y. State Gas & Elec. Cos., 49 P.U.R.4th 329 (N.Y. Pub. Serv. Comm'n 1982).
process. These statutes generally take two forms: anti-CWIP statutes, and other various statutory provisions incorporating the concept of "used and useful" property.

1. Anti-CWIP Statutes. — One type of regulatory statute that some courts and commissions have relied on to deny recovery is the "anti-CWIP" statute, which typically prohibits a utility from placing into its rate base the capitalized costs of raising funds to construct a plant, prior to the time the plant becomes operational.

In In re Public Service Co., the Supreme Court of New Hampshire analyzed that state's anti-CWIP statute at the request of the state commission. The court, in its declaratory ruling, strictly construed the statute's broad regulatory mandate that rates may not be based on construction costs "if said construction work is not completed." Consequently, the court declared that the state commission could not, as a matter of law, permit the utility to recover its investment in the abandoned Pilgrim II nuclear plant through amortization or rate base treatment. The court, however, left open the

106. See infra notes 109-30 and accompanying text.

107. See infra notes 131-75 and accompanying text. State commissions have occasionally denied cost recovery on procedural grounds as well. For example, in In re Arizona Pub. Serv. Co., 38 P.U.R.4th 547 (Ariz. Corp. Comm'n 1980), the Arizona Commission denied recovery for costs associated with the cancelled Palo Verde Units IV and V. The Commission found that the utility had not met its burden of justifying its claim for recovery with sufficient evidence. Id. at 556.

108. CWIP is an acronym for "construction work in progress." See K. Howe & E. Rasmussen, supra note 14, at 92.


Public utility rates or charges shall not in any manner be based on the cost of construction work in progress. At no time shall any rates or charges be based upon any costs associated with construction work if said construction work is not completed. All costs of construction work in progress, including, but not limited to, any costs associated with constructing, owning, maintaining or financing construction work in progress, shall not be included in a utility's rate base nor be allowed as an expense for rate making purposes until, and not before, said construction project is actually providing service to consumers.

Id.

112. Id. See 125 N.H. at 52-55, 480 A.2d at 23-25.

113. 125 N.H. at 55, 480 A.2d at 25.
question of whether the costs could be recovered indirectly from ratepayers through the establishment of a higher rate of return.114

A similar result was reached when the Missouri Public Service Commission interpreted that state’s anti-CWIP statute,115 in In re Union Electric Co.116 At the time, there was no Missouri case law to guide the Commission in interpreting the recent statute and it consequently approached the task with great caution.117 In particular, the Commission feared that if it read the statute to allow recovery by the utility, and its decision was subsequently reversed on appeal, the ratepayers would be placed in the position of temporarily paying rates based on unlawful charges with no assurance of a refund.118 To

The MDPU also dealt with Pilgrim II cancellation costs. Recovery was permitted. See supra notes 81-93 and accompanying text. Massachusetts, however, has no regulatory statutes restricting the scope of recovery. The Supreme Court of New Hampshire was keenly aware of this distinction: “The legislature of Massachusetts has left its commission with the delegated discretion to determine the policy on investment in cancelled plants. The legislature of New Hampshire divested its commission of any discretion in this matter when it passed [the anti-CWIP statute].” 125 N.H. at 57, 480 A.2d at 27.

It is interesting to note that, in the Boston Edison case, one of the arguments advanced for denial of recovery was that the MDPU had previously employed a used and useful test to determine which capital investments belong in the rate base. 46 P.U.R.4th 431, 434-36 (Mass. Dep’t Pub. Utils. 1982), aff’d sub nom. Attorney Gen. v. Department of Pub. Utils., 390 Mass. 208, 455 N.E.2d 414 (1983). In these cases, the utility was found not to be entitled to a return on its investment in property that was not used or useful in providing service to customers. See Fitchburg Gas & Elec. Co. v. Department of Pub. Utils., 375 Mass. 571, 380 N.E.2d 1304 (1978); Boston Edison Co. v. Department of Pub. Utils., 375 Mass. 1, 375 N.E.2d 305, cert. denied, 439 U.S. 921 (1978); Boston Gas Co. v. Department of Pub. Utils., 367 Mass. 92, 324 N.E.2d 372 (1975). The MDPU, however, dismissed these regulatory precedents, stating that “an extraordinary loss of this size requires separate, independent, and unique rules that properly reflect the just balance of the affected interests.” 46 P.U.R.4th at 435.

Many states have incorporated the “used and useful” concept into their regulatory statutes. See infra text accompanying notes 131-75.

114. 125 N.H. at 55, 480 A.2d at 26. For a discussion of indirect recovery, see infra notes 162-78 and accompanying text.

115. Mo. ANN. STAT. § 393.135 (Vernon Supp. 1986). Missouri’s anti-CWIP statute provides:

Any charge made or demanded by an electrical corporation for service, or in connection therewith, which is based on the costs of construction in progress upon any existing or new facility of the electrical corporation, or any other cost associated with owning, operating, maintaining, or financing any property before it is fully operational and used for service, is unjust and unreasonable, and is prohibited. Id.


117. Id. at 172. In fact, the Missouri Commission stated that it regretted that there was no procedural means to avoid the issue, by getting a declaratory judgment from the courts like the New Hampshire Commission did in In re Public Serv. Co. Id. See supra text accompanying notes 111-12.

118. 57 P.U.R.4th at 172.
avoid this possibility, and with the recognition that any decision it reached would be appealed, the Missouri Commission decided to take the prohibitory language of the statute at face value, denying any recovery to the utility.\textsuperscript{119} Thus, the Commission decided to preserve the status quo pending the inevitable appeal to the Missouri Supreme Court.\textsuperscript{120}

The appeal finally reached the Supreme Court of Missouri in \textit{State ex rel. Union Electric Co. v. Public Service Commission}.\textsuperscript{121} The court held that the statute did not, as a matter of law, divest the Missouri Commission of the authority to allow recovery for costs of abandoned construction.\textsuperscript{122} The decision rested in part on a comparison of the Missouri and New Hampshire statutes.\textsuperscript{123} The court noted that while the two statutes are similar in many respects, the New Hampshire statute contains the following additional language, which directly relates to abandoned construction: "At no time shall any rates or charges be based upon any costs associated with construction work if said construction work is not completed. . . ."\textsuperscript{124} The Missouri statute contains no analogous reference to cancellation.\textsuperscript{125} Thus, the court reasoned, the possibility of abandoned construction was not contemplated by its sponsors.\textsuperscript{126} The court concluded that the statute merely addresses the timing of the recovery of normal construction costs for projects that are eventually completed.\textsuperscript{127}

The court apparently sought to avoid the consequences of construing the statute to deny any cost recovery, since an increase in the

\begin{footnotesize}
\begin{enumerate}
\item[119.] \textit{Id.} at 173.
\item[120.] \textit{Id.} at 172.
\item[121.] 687 S.W.2d 162 (Mo. 1985)(en banc).
\item[122.] \textit{Id.} at 168.
\item[123.] \textit{Id.} at 167. \textit{See supra} notes 111 & 115.
\item[124.] 687 S.W.2d at 167. \textit{See supra} note 111.
\item[125.] 687 S.W.2d at 167-68. \textit{See supra} note 115.
\item[126.] 687 S.W.2d at 166.
\begin{quote}
The cost of construction or expansion of a facility undertaken by a public utility producing, generating, transmitting, distributing, or furnishing electricity shall not be made a part of the rate base nor otherwise included in the rates charged by the electric utility until such time as the facility is used and useful in service to the public. Except as stated in this section, no electric utility property shall be deemed used and useful until it is presently providing actual utility service to the customers.
\end{quote}
66 PA. CONS. STAT. ANN. § 1315 (Purdon Supp. 1985). The Pennsylvania Commission found that the statute does not address the cancellation issue, and merely prohibits a utility from collecting rates to support plant construction, prior to completion of that construction. 52 P.U.R.4th at 650-51.
\end{enumerate}
\end{footnotesize}
NUCLEAR PLANT CANCELLATION

risks of loss in utility investment might make it difficult or impossible to raise the capital necessary to provide adequate service to ratepayers. The court suggested that utilities would be reluctant to embark on new construction projects or other long term plans if it meant possible forfeiture of the costs at a later date.

Having determined that the statute did not bar cost recovery as a matter of law, the court remanded the case to the Missouri Commission for an examination of managerial prudence and the other factors involved in the cost allocation decision.

2. Other State Regulatory Schemes. — In addition to anti-CWIP statutes, some state commissions and courts have relied on the language of general regulatory and ratemaking statutes in making their cost allocation decisions. The kinds of statutory provisions relied upon are so diverse that it is difficult to determine if these decisions signify a trend. Most incorporate the concept of "used and useful" property. One common factor in the decisions is the use of general regulatory language as the basis for denying cost recovery.

For example, in In re Pacific Power & Light Co., the Montana Public Service Commission relied on a general ratemaking statute authorizing it to investigate and ascertain the value of "used and useful" property, as the basis for its decision denying cost recovery for two abandoned nuclear plants. The Montana Commission read this language to mean that a utility can recover from ratepayers only the costs of investments in property which are actually used and useful in providing utility service for ratepayers. Since the abandoned nuclear plants never became used or useful, no recovery was permitted.

The Commission's decision does not consider the likely adverse economic consequences to the utility. Instead, the decision focuses on the general fairness concept that ratepayers should not be forced to pay for a bad decision when they had no part in making it.

128. 687 S.W.2d at 166.
129. Id.
130. Id. at 168.
131. See supra notes 49-52 and accompanying text.
133. MONT. CODE ANN. § 69-3-109 (1985). The statute provides: "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." Id.
134. 53 P.U.R.4th at 27.
135. Id.
136. Id. at 31.
137. Id. at 27.
deed, the Commission openly stated that the risks of investment
must be borne by the shareholder because it is he, through the
management he selects, who decides which projects will be pursued.\footnote{138}

The Commission further stated that to expect the ratepayer to com-
penstate the shareholder for company losses is to guarantee recovery
of shareholder investments.\footnote{139}

In \textit{In re Central Maine Power Co.},\footnote{140} cost recovery denial was
based on a very different kind of regulatory statute, dealing explicit-
ly with allocating the costs of abandoned plants.\footnote{141} The statute was
divided into two parts. The first part prohibited the Commission
from considering cost recovery of abandoned plants “until after the
date last announced for completion of the plant by the lead partici-
pant.”\footnote{142} Because this completion date had not yet passed, the Com-
mision stated that it could not, at that time, grant recovery.\footnote{143}

The Commission then turned to the second part of the statute,
which outlined an exception to the first part if the utility could show
that a denial of recovery would prevent the utility from providing
services or attracting capital.\footnote{144} The Commission found that, while it
was clear that the utility's investors had suffered a substantial loss,
the utility did not meet its burden of showing that this loss would
impair either utility service or its ability to attract capital.\footnote{145} Accor-
ding to the Commission, the financial strain on the utility was due
more to an unrelated construction program than to its investment in
the abandoned nuclear plant.\footnote{146} Thus, because neither element of the
statute had been satisfied, the Commission, as a matter of law, could

\footnotesize{\textsuperscript{138} Id. at 29.}
\footnotesize{\textsuperscript{139} Id.}
\footnotesize{\textsuperscript{140} 57 P.U.R.4th 488 (Me. P.U.C. 1983). The case concerned the utility's investment
in the abandoned Pilgrim II plant. For other cases involving the allocation of the costs of the
Pilgrim II plant, see \textit{supra} notes 81-93 and accompanying text.}
provided, in pertinent part:}
\footnotesize{\begin{quote}
The commission shall not, with respect to any canceled or abandoned electric
generating facility, issue any order concerning the recovery from ratepayers of all or
any portion of the cost of that facility until after the date last announced for com-
pletion of the plant by the lead participant. This section does not apply if an electrical
company can establish . . . that it will be unable to perform its public service or
attract necessary capital on just and reasonable terms . . . .
\end{quote}}
\footnotesize{Id.}
\footnotesize{\textsuperscript{142} Id.}
\footnotesize{\textsuperscript{143} 57 P.U.R.4th at 508.}
\footnotesize{\textsuperscript{144} See \textit{supra} note 141.}
\footnotesize{\textsuperscript{145} 57 P.U.R.4th at 509.}
\footnotesize{\textsuperscript{146} Id. at 509-10.}
not grant cost recovery.\textsuperscript{147}

The Maine statute represented an interesting and unusual attempt to balance the risk of loss between investors and ratepayers. By prohibiting any cost allocation decision on abandoned plants until the last date announced for completion,\textsuperscript{148} it prevented ratepayers from having to compensate for construction costs, at least until the time they would have started paying had the construction been completed. Furthermore, through the "financial health exception,"\textsuperscript{149} the Maine legislature apparently recognized that a denial of cost recovery can, in some instances, weaken the financial status of a utility to the point where it can no longer raise new capital. The Maine statute was repealed, however, in favor of an even simpler and more direct legislative mandate: "In determining the rate-making treatment for a utility's investment in cancelled or abandoned electric generating facilities, the commission shall balance the interests of the utility and ratepayers in a just and reasonable manner in each individual case."\textsuperscript{150}

Indiana is the most recent state to interpret provisions of its regulatory legislation to prohibit recovery of abandonment costs. In \textit{Citizens Action Coalition v. Northern Indiana Public Service Co.},\textsuperscript{151} a sharply divided Supreme Court of Indiana held that the utility could not amortize the cancellation costs of its Bailly N-1 nuclear plant because, under that state's statutory scheme,\textsuperscript{152} a utility's charges

\begin{itemize}
\item \textsuperscript{147} Id. at 507-10.
\item \textsuperscript{148} See supra note 141.
\item \textsuperscript{149} Id.
\item \textsuperscript{151} 485 N.E.2d 610 (Ind. 1985).
\item \textsuperscript{152} Ind. Code Ann. §§ 8-1-2-1, -4 (West Supp. 1985). The court first examined § 8-1-2-4 of the Indiana Code, which provides that: "The charge made by any public utility for any service rendered or to be rendered either directly or in connection therewith shall be reasonable and just." Id. at 612-13. The court next examined the term "service" as defined in § 8-1-2-1 of the Indiana Code:
\begin{quote}
The term "service" is used in this chapter in its broadest and most inclusive sense and includes not only the use or accommodation afforded consumers or patrons but also any product or commodity furnished by any public or other utility and the plant, equipment, apparatus, appliances, property and facility employed by any public or other utility in performing any service or in furnishing any product or commodity and devoted to the purposes in which such public or other utility is engaged and to the use and accommodation of the public (emphasis added).
\end{quote}
\textit{Id.} at 613. Taking these two provisions together, the court noted that the costs of plant may be included in a utility's charge for service. The court was quick to point out, however, that this did not end the inquiry because, under Indiana law, only property that is used or useful can be valued for rate purposes. The court cited no authority for this proposition. 485 N.E.2d at 614. The "used and useful" concept does appear, however, in § 8-1-2-6(a) of the Indiana
can only reflect the value of property, plant and equipment that is used and useful. The court rejected arguments that the state legislature had acquiesced to the practice of permitting cost recovery by failing to amend the statutes, knowing that amortization had been permitted for abandoned plants in previous cases.

The dissenters vigorously attacked the decision, which one referred to as "a societal disaster." The dissenters focused their attentions on the economic realities of the cost allocation decision. Chief Justice Givan chastized the majority for its naivete in thinking that shareholders could somehow pay the costs: "It does a disservice to the parties to this litigation and to the public generally to engage in semantics which tend to build a false picture that in some manner some of the debts of the corporation will be paid in a manner other than the collection of rates." According to Chief Justice Givan, ratepayers are the only source of revenue for a utility and, in reality, no funds are raised by depriving utility shareholders of a return.

Justice Prentice, in dissent, focused on the allocation of risks between investors and ratepayers. He opined that it is unrealistic and unreasonable to expect investors to assume all of the risks when the ratepayers reap the greatest benefits from utility services. The Justice further noted that "[p]rudent management is the responsibi-

Code, which provides, in part: "The commission shall value all property of every public utility actually used and useful for the convenience of the public at its fair value . . . ." Ind. Code Ann. § 8-1-2-6(a) (West 1982).


154. Id. at 615-16. The court pointed out that only one of the numerous cases cited to illustrate the past practice had actually permitted cost recovery for an abandoned plant. Id.
155. Citizens Action Coalition, 485 N.E.2d at 613-17. See In re Indiana & Mich. Elec. Co., No. 35251 (Ind. Pub. Serv. Comm'n Sept. 21, 1978). The rest allowed recovery for plants that had been used and useful property but were retired from service. The court distinguished between this kind of abandonment and the abandonment of a plant that never became used and useful: "Allowance of amortization of cancelled plants [that never became used and useful] would encourage uneconomical or unproductive ventures; whereas, allowance for . . . retired plants encourages utilities to remove obsolete plants and property from the ratebase." Citizens Action Coalition, 485 N.E.2d at 616.
157. Id. at 620 (Givan, C.J., dissenting).
158. Id. (Givan, C.J., dissenting).
159. Id. at 623-24 (Prentice, J., dissenting).
160. Id. (Prentice, J., dissenting).
ity of the investor. Infallible management and the production of utopian services at rates that will please the consumers are not.\footnote{161}

The \textit{Citizens Action Coalition} opinion is important because it clearly illustrates the tension between the desire to be fair to ratepayers and the need to avoid adverse economic consequences. The majority opinion ignores the economic issues associated with the allocation of cancellation costs. By not addressing the likely economic results, the court implicitly accepts the possibility that services might be impaired if the utility’s financial predicament worsens.

Perhaps the most litigation over cancellation costs occurred in Ohio. In 1980, a consortium of five utilities operating in Ohio and Pennsylvania, named the Central Area Power Coordination Group (CAPCO),\footnote{162} decided to terminate the construction of four nuclear plants.\footnote{163} Each of the Ohio utilities applied to the Ohio Public Utilities Commission for permission to amortize the cancellation costs.\footnote{164} To support their claims for cost recovery, the utilities argued that ratepayers should pay because the costs were incurred on their behalf.\footnote{165} The Ohio Commission permitted cost recovery.\footnote{166}

The Ohio Supreme Court reversed in \textit{Office of Consumers' Counsel v. Public Utilities Commission (Consumers' Counsel I)}.\footnote{167} The court held that, under Ohio’s regulatory statutes, only “used and useful” property could be valuated in the determination of rates.\footnote{168} The court rejected the argument that the state commission’s

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\footnote{161. \textit{Id.} at 624 (Prentice, J., dissenting).}
\footnote{163. \textit{Office of Consumers’ Counsel, 67 Ohio St. 2d 153, 154, 423 N.E.2d 820, 821 (1981). The four cancelled plants were Davis-Besse Units 2 and 3, and Erie Units 1 and 2. \textit{Id.} at 153 n.1, 423 N.E.2d at 821 n.1.}
\footnote{164. \textit{In re Cleveland Elec. Illuminating Co., 38 P.U.R.4th 494 (Ohio P.U.C. 1980).}}
\footnote{165. \textit{Id.} at 525-27.}
\footnote{166. \textit{Id.} at 526-27. In a series of decisions, the Ohio Commission established the following policy with regard to CAPCO cancellation costs: Each utility would be permitted to amortize its share of costs, including AFUDC, over ten years, but none would be permitted to earn a return on its unamortized balance through rate base treatment. The Commission stated that this treatment was in the public interest since the decisions to commence and cancel construction were prudently made. \textit{In re Ohio Edison Co., No. 80-141-EL-AIR (Ohio P.U.C. Feb. 11, 1981); In re Toledo Edison Co., 42 P.U.R.4th 568, 589-91 (Ohio P.U.C. 1981); In re Cleveland Elec. Illuminating Co., 38 P.U.R.4th 494, 525-27 (Ohio P.U.C. 1980).}}
\footnote{168. \textit{Id.} at 163-64, 423 N.E.2d at 827. The Ohio statute in effect at the time provided,}
decision was necessary to preserve the financial health of the CAPCO utilities, noting that if relief of this sort was necessary, the utilities should approach the legislature to amend the statute.169

Two years later, one of the utilities returned to the Ohio Supreme Court, urging it to reconsider its earlier decision. The court declined.170 In a companion decision, however, the court affirmed a ruling of the state commission that the utility's shareholders should receive a higher rate of return on equity to reflect the increased risks to investors caused by the court's Consumers' Counsel I decision.171 The dissent vigorously argued that this effectively reversed Consumers' Counsel I.172

The Ohio CAPCO decisions illustrate the concept of indirect recovery. The Ohio Commission raised rates based on its authority to control the rate of return the utility's shareholders should receive.173 This higher rate of return for shareholders was to offset the increased risks of investment in the utility, caused by the denial of cost recovery for the abandoned plants.174 Thus, a utility may sometimes collect indirectly, through a higher rate of return on equity,

in part: “The public utilities commission, when fixing and determining just and reasonable rates . . . shall determine: (1) The valuation as of the date certain of the property of the public utility used and useful in rendering the public utility service for which rates are to be fixed and determined.” OHIO REV. CODE ANN. § 4909.15(A)(1) (Page 1977).

The statute has since been amended, adding provisions to deal more specifically with abandoned projects and allowances for CWIP. See OHIO REV. CODE ANN. § 4909.15(A)(1) (Page Supp. 1984).

169. Consumers' Counsel I, 67 Ohio St. 2d at 167, 423 N.E.2d at 829. The statute was amended, but not in a way that is favorable to utilities abandoning plants. The amendment provides that if a utility cancels a project for which a CWIP allowance was permitted, the allowance is excluded from the project's valuation and any revenues collected by the utility as a result of the prior inclusion of the allowance is offset against future revenues. OHIO REV. CODE ANN. § 4909.15(A)(1) (Page Supp. 1984).


Although the nuclear stations cancelled by the CAPCO utilities will never be completed, a consortium of other Ohio utilities is attempting to convert the proposed Zimmer plant to coal, to avoid cancelling the plant. The utilities hope to avoid the fate suffered by the CAPCO utilities. Zimmer Conversion is 'one of a kind,' ELECTRICAL WORLD, Mar. 1985, at 42.


172. Id. at 116-17, 447 N.E.2d at 754-55 (Locher, J., dissenting).

173. Id. at 114-15, 447 N.E.2d at 752-54. Return on equity represents the profit to be provided to utility shareholders in return for their investment in the utility's business. The rate of return is controlled by state regulatory commissions. See R. Morin, supra note 26, at 20-28. See also text accompanying note 15.

what it was prohibited from collecting through amortization. Despite a utility’s inability to directly recover abandonment losses, such increases in a utility’s rate of return on equity will result in consumers paying higher rates. The concept of indirect recovery represents a mechanism by which the ratemaking process may mitigate the effect of statutes which restrict direct recovery.175

CONCLUSION

The allocation of plant cancellation costs, like most areas of utility regulation, requires the equitable balancing of investor and ratepayer interests. As the difficult process of cancellation and consolidation continues in the nation’s nuclear power industry, state regulators will continue to allocate these costs. In the majority of states, utilities will be permitted ratepayer recovery of at least some of the costs of plants which will never provide power. This is so because even prudent management cannot accurately foresee future events. The experiences of the last decade, however, suggest that utilities planning future generating capacity will exercise care to insure that planned plants will be completed and brought on line. If demand for new power is sufficient and the nuclear option is the sound economic choice given competing technologies, nuclear generating stations will be built (assuming the safety-related problems are solved). If, however, nuclear power cannot compete with other potential sources of power, the future of this technology is dim, regardless of the regulatory treatment given utilities for plants that have been cancelled in the past. While past cancellation decisions may affect investor perceptions of individual utilities in the short-term, the viability of future construction — whether nuclear, coal or some other technology — will be determined by a careful assessment of the economic and financial merits of proposed additions to generating capacity.

175. Indirect recovery was again permitted by the Ohio Supreme Court in Office of Consumers’ Counsel v. Public Utils. Comm’n, 6 Ohio St. 3d 405, 453 N.E.2d 584 (1983) (per curiam).