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REGULATING THE TERMINATION OF A PROPOSED NUCLEAR POWER PLANT IN TEXAS: THE ALLENS CREEK EXPERIENCE

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I. INTRODUCTION

Houston Lighting and Power (HL&P) filed an application to change rates with the Texas Public Utility Commission (PUC) and other original jurisdictional regulatory authorities on June 16, 1982.[1] Its request included a proposal to terminate plans to construct a nu-

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1. *See* Docket No. 4540, Application of Houston Lighting and Power Company for a Rate Increase, Cities' Brief 2 (Dec. 6, 1982); *see also* TEX. REV. CIV. STAT. ANN. art. 1446c, § 17(a) (Vernon 1980). Section 17(a) provides in pertinent part:

> Subject to the limitations imposed in this Act, and for the purpose of regulating rates and services so that such rates may be fair, just, and reasonable, and the services adequate and efficient, the governing body of each municipality shall have exclusive origi-

clear power plant at its Allens Creek site. Had that proposal been accepted, HL&P would have been allowed: (1) to write-off $362 million previously invested in the project as a loss; (2) to amortize those dollars over a ten year period using a declining balance method; and (3) to pass that cost on to its rate payers as an allowable expense.

The HL&P proposal was not unique; nor was it a case of first impression in Texas.[2] Over the past seven years, a number of nuclear plant termination write-off cases have been adjudicated, and in all but a few, the various state commissions have allowed the write-offs in one form or another.[3] There is one exception. The Ohio Supreme Court reversed its state utility commission's decision to allow a write-off[4] and ruled that cost of service expenses meant nor-

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nal jurisdiction over all electric, water, and sewer utility rates, operations, and services provided by an electric, water, and sewer utility within its city or town limits.

Id.

Regulatory authority may mean the railroad commission, public utility commission, or the governing body of a municipality. *See id.* § 3(g).

2. *See* Docket No. 2677, Application of Gulf States Utilities Company for Authority to Change Rates 1 (Oct. 12, 1979); Docket No. 2001, Application of Houston Lighting and Power Company for Authority to Change Rates 543 (Nov. 27, 1978).

The decision in *Gulf States* was reached through the stipulation of the parties. Stipulation 4, provided "that the company may properly reflect the effect of this settlement on its books, the cancellation costs of the Blue Hills nuclear project shall be amortized over a five-year period as a cost of service item." Docket No. 2677, Application of Gulf States Utilities Company for Authority to Change Rates 4 (Oct. 12, 1979).

In Docket 2001, the Commission found "that HL&P's proposed amortization of cancellation charges associated with the discontinuance of the Allens Creek No. 2 Nuclear Unit [was] unreasonable, in that no return should be earned on the unamortized portion of such charges." Docket No. 2001, Application of Houston Lighting and Power Company for Authority to Change Rates 543 (Nov. 27, 1978). It should be noted that in neither instance did the staff, parties, or intervenors challenge the discontinuance of service, the procedural mechanism for determining the appropriateness of the expense, or the legality of the write-off. The write-off was presumed an appropriate device, leaving only the question of rate treatment.

3. *See, e.g., In re* San Diego Gas & Elec. Co., 29 Pub. Util. Rep. 4th 613, 645 (1979) (losses amortized); *In re* Virginia Elec. & Power Co., 29 Pub. Util. Rep. 4th 65, 97 (1979) (necessary to include abandonment costs in rate base); *In re* Potomac Elec. Power Co., 29 Pub. Util. Rep. 4th 517, 579 (1979) (proper to amortize costs); *see also* Bruder, *Recovery of Losses on Cancelled Projects: Basic Issues,* 1982 Practising Law Inst. 175 (various states allow recovery of abandonment costs).

4. *See* Office of Consumers' Counsel v. Public Util. Comm'n, 423 N.E.2d 820, 826 (Ohio 1981). The Cleveland Electric Illuminating Company, in conjunction with other electric companies, attempted to construct four nuclear power plants. *See id.* at 821. Unforeseen costs and circumstances, however, resulted in termination of the construction of all four plants. *See id.* at 821. As a result, Cleveland Electric attempted to amortize their investment

mal recurring operating expenses.[5] In other words, a loss resulting from the termination of an incompleted nuclear power plant could not be construed as a normal operating expense.[6]

Overall, HL&P's proposal contained features similar to those which had been put forth by the other utilities. It had proposed: (1) passing the write-off through to its rate payers; (2) amortizing the total cost over a specific span of time; (3) legitimizing its conduct in handling the project developments (or lack thereof) as prudent management; and (4) maintaining that its pass-through strategy benefitted its rate payer. Beyond those points, however, HL&P's termination proposal raised issues of administrative and regulatory process which were significantly different.

The purpose of this article is to explore those differences in light of Texas regulatory and administrative law. First, it is questionable whether the alleged loss had matured to a point where rate base treatment of the expenses could have been properly applied. Second, there are serious questions as to the legality of a unilateral decision to cancel a Certificate of Convenience and Necessity (CCN). Third, it is unclear as to what the proper forum should be in which to decide a termination issue. Fourth, it is doubtful that the proposed method of apportionment could ever be reasonable and fifth, there is an inconsistency between the type of loss or expenses occasioned by the termination of Allens Creek and the type of expenses normally contemplated by the Texas Public Utility Regulatory Act (PURA).

A. *History of Allens Creek*

The Allens Creek Nuclear Project was initiated in August, 1971.[7] The plan originally called for the construction of two 2400 megawatt (MW) plants. On September 10, 1975, however, the initial plan

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over a ten-year period and impose upon its customers a $69.6 million rate increase. *See id.* at 821.

5. *See id.* at 829. The court noted that normal expenses include reasonable expenditures for administrative expenses, repairs, and taxes. Expenses, on the other hand, resulting from the terminated plants were specifically excluded from normal operating expenses so that investors could not recoup their contribution at the ratepayers' expense. *See id.* at 829.

6. *See* id. at 827.

7. *See* Docket No. 88, Application of Houston Lighting and Power Company for a Certificate of Convenience and Necessity for the Allens Creek Nuclear Generating Station, Examiner's Report (Jan. 5, 1977). The Company set out the following chronology of events:

was suspended or deferred. The Company's reasons for discontinuing construction activities were: (1) the agitation caused by quadrupled prices for imported oil; (2) the inflationary spiral which increased costs of boiler fuels for electric generation; (3) a flattened economy that diminished the company's expectations of future load increases; (4) an increase in construction cost estimates resulting from cost escalations and higher interest rates; and (5) other financial problems resulting from delays in finishing a protracted rate case proceeding.[8]

The Company reevaluated that decision in late 1976, and announced its intention to restart construction, but only to build one 1200 MW unit. It filed a motion for rehearing and an alternative motion to reopen proceedings relating to Allens Creek on September 9, 1976, before the PUC.[9] The hearing was held in October, 1976, at which time only the Company and staff appeared.[10]

The key issue in that hearing centered around whether HL&P was entitled to a section 53 CCN given its decision to suspend operation

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Event	Date
Nuclear effort started	August 1971
Acquisition of land began	January 1972
Contracted for nuclear steam supply system	August 1972
Contracted for use of Brazos River water	August 1972
Contracted for the turbine — generator units	March 1973
Made application to AEC for a construction permit	August 1973
Receive docket number from AEC	December 1973
Acquisition of land completed	February 1974
Contracted for power transformer	April 1974
Contracted for containment vessel	October 1974
Received final environmental statement from NRC	November 1974
Held Advisory Committee on Reaction Safety (ACRS) Hearing	December 1974
Held Environmental Hearing	March 1975
Indefinite postponement	September 1975
Initial decision on site suitability	November 1975

Id. There is, however, some disagreement about the initial date since the examiner cites August, 1972 as the beginning of the project. *See id.*; Docket No. 4540, Application of Houston Lighting and Power Company for a Rate Increase 2 (Dec. 6, 1982).

8. *See* Docket No. 4540, Application of Houston Lighting and Power Company for a Rate Increase, Direct Testimony of Don D. Jordan 7-8 (May 25, 1982).

9. *See* Docket No. 88, Application of Houston Lighting and Power Company for a Certificate of Convenience and Necessity for the Allens Creek Nuclear Generating Station, Examiner's Report 1 (Jan. 5, 1977).

10. *See id.* at 1.

in 1975.[11] The Company maintained that it was entitled to certification based upon the large expenditures it had made before the suspension or deferral date.[12] HL&P supported its claim by pointing out that after the "deferral" decision was announced, it had continued its efforts to secure licensing with the Nuclear Regulatory Commission (NRC) and had not canceled any of its major project equipment contracts.[13] Moreover, it had persisted in trying to get a construction permit from the Texas Water Rights Commission and was making payments to the Brazos River Authority for water to be used.[14]

Both the PUC staff and the hearing examiner recommended that the Company be granted a section 53 certificate. Their recommendations were based on the Company's representation that it had continued the project activities subsequent to the "deferred" or "suspension" decision. Hence, they found the Company's behavior was sufficient evidence to "alleviate any doubt that the Commission would [have been] certificating a dead project,"[15] and concluded that there had not been an "abandonment" and that HL&P was "entitled to a Certificate of Convenience and Necessity"[16] for that project and all associated transmission lines. The Commission issued its order to that effect in January, 1977.

From 1977 to June, 1982, the Company continued its efforts to secure an NRC license. According to its Chief Executive Officer, Don D. Jordan, however, during that same period of time the Company underwent significant changes.[17] As more and more information became available, the Company allegedly updated its cost

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11. *See id.* at 1.
12. *See id.* at 1.
13. *See id.* at 2.
14. *See id.* at 2.
15. *Id.* at 2.
16. *Id.* at 3.
17. Docket No. 4540, Application of Houston Lighting and Power Company for a Rate Increase, Direct Testimony of Don D. Jordan 9 (May 25, 1982). In prefiled testimony, Jordan described those changes as follows:

> First, debt capital, if available at all . . . [became] more costly; the last two issues [had] terms of only 10 years and the last issue's cost to the Company was 15.42%. Second, in contrast to the early 1970's, the last eight sales of common stock . . . [were] at prices below book value, which . . . diluted the investment of existing shareholders. Third, at the same time that the capital market . . . changed dramatically, continued and virtually unprecedented inflation . . . drastically increased construction costs of new power plants. While increases in construction costs . . . exceeded the general rate of inflation

comparisons between coal and nuclear units and by early 1981, it was giving "renewed consideration" to the cancellation of Allens Creek.[18] While the election of Ronald Reagan as President of the United States revived the Company's optimism, that outlook was short-lived; it lasted at best until it became clear that the new administration's promises of support and the appointees it selected for the regulatory commission "were not sufficient to bring early improvement to the NRC's licensing procedures."[19] In addition, the Company "had increases in the cost estimates for [its] Limestone and Malakoff Lignite Projects, along with a slippage of the in-service date and increased cost estimate for the South Texas Nuclear Project."[20] With all those factors considered together, HL&P concluded it "could not finance its portion of the South Texas Project, Allens Creek, and four lignite units over the next four to five years."[21]

In light of those changes, HL&P retained the services of Energy Management Associates (EMA) to conduct an independent study which it hoped would either "validate or disprove the tentative conclusions" of its own studies.[22] EMA's independent evaluation found that "expenditures on Allens Creek should be held to a minimum" because of the problems in allocating available financial resources with the associate risks such as the uncertainty of cost and schedule estimates and the inherent possiblity of a nuclear project shutdown.[23] While the EMA study supported the Company's conclusion relating to cost and cost comparisons, it fell short of calling for an immediate termination of the Allens Creek project. Instead, it concluded that cancellation was a "viable alternative" if it could be instituted without damaging the Company's ability in proceeding with a new construction schedule that would "substitute coal and lignite capacity in a timely manner."[24]

The Company crafted the EMA findings and recommendations

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for all types of power plants, the cost of nuclear plants . . . increased even more substantially.

Id.

18. *See id.* at 10.
19. *See id.* at 10.
20. *Id.* at 10.
21. *Id.* at 10.
22. *See id.* at 11.
23. *See id.* at 11-12.
24. *Id.* at 12.

into the proposition that "[i]f the Allens Creek Project were to be continued, other planned units [would have to] be delayed in order to keep the construction budget at manageable levels."[25] The Company's alternative, on the other hand, was to terminate Allens Creek without being granted rate relief to recover its entire investment. That decision, according to the Company's Vice President and Comptroller, R.S. Letbetter, would result in the investment being written off against income, which would result in an "after-tax charge against income in excess of 200 million."[26] The consequence thereof would "prohibit the Company from obtaining capital from the sale of mortgage bond or preferred stock for a period of up to twelve months because the provisions of the Mortgage and Charter . . . could not be met;" moreover, it "would effectively shut down the Company's construction program and lead to significantly greater cost of the units under construction."[27] Overall, the EMA recommendation of a revised construction program depended solely on HL&P being able to recoup its total investment cost. Therefore, when the Company raised the write-off issue for resolution in Docket Number 4540, the threshold question became one of whether Allens Creek had been abandoned, cancelled, or both, and if it had been abandoned and/or cancelled, under what circumstance would the Company be entitled to rate relief.

B. *Termination of Allens Creek*

HL&P appeared before the PUC on August 26, 1982, and announced publicly for the first time that it had decided to terminate its efforts to construct a nuclear generating facility at Allens Creek.[28] Until then, the Company had not taken any official steps to withdraw its NRC license application nor to seek decertification from the PUC. In fact, Jordan consistently held firm to the proposition that while he hoped the PUC would work with the Company to accomplish an abandonment or cancellation of the project, [i]n the interim, [the Company would] take no action which would irrevocably foreclose or jeopardize a decision on [its] application for a con-

25. *Id.* at 12.

26. Docket No. 4540, Application of Houston Lighting and Power Company for a Rate Increase, Direct Testimony of R.S. Letbetter 19 (May 25, 1982).

27. *Id.* at 19.

28. *See* Docket No. 4540, Application of Houston Lighting and Power Company for a Rate Increase, Cities' Brief 3 (Dec. 6 1982).

struction permit."[29]

Given that history, it seems that the Commission would have given more weight to the Company's intent in evaluating the proposed cancellation since intent is always a key factor in assessing prudent management decision-making. Instead, the Commission merely acknowledged that the company had "walked a fine line" on the Allens Creek nuclear project and that "[o]nly when it was clear that its balancing act was working to its disadvantage" did HL&P formally attempt to cancel the project, and that decision occurred four days before the hearing.[30] Despite the Commission's admonishment of the Company for imprudent managerial decision-making, it nevertheless concluded that HL&P's conduct was procedurally proper, and the Commission proceeded to treat Allens Creek as though it had been formally terminated. As the examiner noted, it was difficult to imagine what else the Company could do besides cancelling the plant.[31]

The PUC's treatment of the Allens Creek Project was astonishing. It took a highly complex process, one of first impression, and simplified it into a two-step procedure. Stated simply, if there is an announcement of a formal cancellation and the NRC terminates its licensing proceedings, then cancellation is a *fait accompli.*[32]

The Commission's perspective of the termination process was somewhat out of focus. First, its decision had to be based solely on the record[33] and a review of the record would only show a formal

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29. Docket No. 4540, Application of Houston Lighting and Power Company for a Rate Increase, Direct Testimony of Don D. Jordan 12 (May 25, 1982).

30. Docket No. 4540, Application of Houston Lighting and Power Company for a Rate Increase, Examiner's Report 45 (Dec. 6, 1982). HL&P management at its very best only recommended cancellation. *See id.* at 45. Moreover, the Commission also admitted that "it was improper for [HL&P] to approach its regulators in the context of a rate case (whether the regulators be the Cities', staff or [the] Commission), to 'test the waters' on what sort of monetary treatment its management decision would receive before [a cancellation] decision was made." *Id.* at 46.

31. *See id.* at 47.

32. *See id.* at 47.

33. *See* TEX. REV. CIV. STAT. ANN. art. 6252-13a, § 16(b) (Vernon Supp. 1982-1983). In a contested case, the record includes:

> (1) all pleadings, motions, and intermediate rulings; (2) evidence received or considered; (3) a statement of matters officially noticed; (4) questions and offers of proof, objections, and rulings of them; (5) proposed findings and exceptions; (6) any decision, opinion, or report by the officer presiding at the hearing; and (7) all staff memoranda or data submitted to or considered by the hearing officer or members of agency who are involved in making the decision.

intent to cancel, i.e., that which had been publicly announced on August 26, 1982. The record would not officially reflect a finding that the NRC had in fact terminated the licensing proceeding before, or concurrent with, the termination announcement or that the Company was in the process of officially terminating the licensing process at that time. Nor would there be any evidence in the record indicating that HL&P had, prior to the announcement, notified the NRC of its desire to bring the proceeding to a close. At best, the record would support the contention that the NRC had not affirmatively acted on the formal license application as of the August 26 date; or perhaps, that the agency would not have opposed a termination request. Regardless, neither situation would be evidentiary of a NRC termination, actual or constructive.

At this juncture, some consideration must be given to the nuclear licensing process, and in particular, the interface between the federal and state authorities. Up to this point, both the behavior and reaction of HL&P and the Commission tend to suggest that the Company has greater unilateral power than it might actually have by law. In other words, the Company has been treated as though it were free to exercise its corporate decision-making without any regard for formal process or procedure — either federal or state — which is not the case.

From a regulatory perspective, there is no question as to who has overall jurisdictional responsibility for regulating nuclear facilities. That field was preempted for the federal government by the Atomic Energy Act of 1954.[34] Pre-emption, however, was not total. The grant of exclusive jurisdiction to the NRC extends only to the licensing and regulating of construction, maintenance, and operations. The states keep and continue to employ their traditional regulatory control over generation, sales, and power transmission produced through those facilities.[35] Therefore, notwithstanding NRC's exclusive jurisdiction, the states control the purse strings and thereby control the financial wherewithal for paying for and maintaining nuclear facilities.[36] Thus, in order to qualify for a license, an appli-

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Id. § 13(a)(f)(1)-(7).

34. *See* 10 C.F.R. § 8.4(c) (1982) (explanation of the Atomic Energy Act).

35. *See id.* § 8.4(d).

36. A dramatic example of local control of the purse strings is the treatment given the Seabrook Nuclear Plant by the New Hampshire regulators. *See* The Wall Street Journal, Vol. No. 12, July 19, 1982, col. 1, p.5. "New Hampshire regulators . . . barred Public Serv-

cant must show the NRC that it possesses the financial abilities to accomplish the business for which the permit or license is being sought.[37] This proof requirement means that it is incumbent on the applicant to show that it has the necessary funds for estimated costs of construction and related fuel cycle costs, or that it is reasonably confident of obtaining the funds, or, finally, a combination of the two.[38] In this latter respect, the state's impact on the licensing proceeding is direct and immediate. Likewise, state attitudes and inclinations toward nuclear plant financing definitely influences the NRC's response in the nuclear application process.[39]

Another indicator of the state's regulatory interface in the nuclear licensing process is evidenced in those jurisdictions which, like Texas, require a CCN as a prerequisite for increasing a utility generating capacity.[40] Where required, a CCN must necessarily precede an NRC license application.[41] Thus, even though it is not expressly set forth in the federal licensing process, the states' participation in both the nuclear licensing and termination processes is a precondition as well as a continuing duty. Certainly, their formal procedural functions in those processes cannot be ignored, bypassed, or minimized.

II. ALLENS CREEK AND CERTIFICATION

The State of Texas played a *de minimis* role in the initial licensing of Allens Creek. HL&P applied for the license to build the two unit, 2400 MW plant before the effective date of the Act;[42] hence, the

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ices Co. . . . from spending proceeds from future financings on construction of the [Seabrook Nuclear Plant Unit No. 2]. . . . The latest developments . . . began in January when the Commission ordered Public Service Co. to reduce its Seabrook stake and to sell its 4% interest in Millstone 3 nuclear plant." *Id.*

37. 10 C.F.R. § 50.33(f) (1982).

38. *See id.* § 50.33(f).

39. *See id.* § 50.33(f).

40. *See* TEX. REV. CIV. STAT. ANN. art. 1446c, § 50 (Vernon 1980).

41. *See In re* Virginia Elec. & Power Co., 29 Pub. Util. Rep. 4th 65, 76 n.23 (1979). A certificate of Public Convenience and Necessity was issued in 1974 when the Commission approved the project; the Atomic Energy Commission did not issue a construction permit until 1975. *See id.* at 76 n.23; *see also In re* Washington Elec. Co-Op, Inc., 45 Pub. Util. Rep. 4th 178, 179 (1982) (certificate of public good required before utility may begin construction).

42. *See* TEX. REV. CIV. STAT. ANN. art. 1446c, § 88 (Vernon 1980). "This Act shall become effective on September 1, 1975 . . . ." *Id.*

project was grandfathered.[43] When the Company decided, however, to suspend or defer its construction activities in 1975 and then almost one year later proposed to reactivate the project,[44] the PUC found itself confronted with an interesting dilemma — which type of certification, if any, was required under the circumstances. The PURA provides two methods for certification. First, there is the section 50 certification or *general certification* provision,[45] and secondly, for those services or facilities which were underway before the Act became effective, there is the section 53 certification or *grandfather provision.*[46] As prescribed by statute, the Company filed for certification within the six month period.[47] When it decided, however, to reactivate actual construction on September 2, 1976, the Company did not know whether it could carry out those plans under the initial request for section 53 certification or whether it had to reapply for certification under section 50.

The important factor up to that point was that regardless of which certification section was applicable, the Company knew it could not continue the project without acquiring some form of official certification. Moreover, it realized it had further exacerbated the situation

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43. *See id.* § 53.

44. Docket No. 88, Application of Houston Lighting and Power Company for a Certificate of Convenience and Necessity for the Allens Creek Nuclear Generating Station, Examiner's Report 2-3 (Jan. 5, 1977). The Company suspended activities on September 10, 1975 and announced reactivation on September 2, 1976. *See id.* at 2.

45. *See* TEX. REV. CIV. STAT. ANN. art. 1446c, § 50 (Vernon 1980). Section 50 provides that:

> Beginning one year after the effective date of [the] Act, . . . (1) no public utility may in any way render service directly or indirectly to the public under any franchise or permit without first having obtained . . . a certificate that the present or future public convenience and necessity require or will require such installation, operation, or extention.

Id.

46. *See id.* § 53. Section 53 provides that:

> On application made to the Commission within six months after the effective date of [the] Act, the Commission shall issue a certificate of public convenience and necessity for the construction or operation then being conducted to any public utility actually providing service to any geographical area on the effective date of [the] Act, or to any person or corporation actively engaged on the effective date of [the] Act in the construction, installation, extension, or improvement, or addition to, any facility or system used or to be used in providing public utility service.

Id.

47. *See* Docket No. 88, Application of Houston Lighting and Power Company for a Certificate of Convenience and Necessity for the Allens Creek Nuclear Generating Station, Examiner's Report 1 (Jan. 5, 1977). The examiner's report cites March 1, 1975, and that date is probably correct since the Act was not effective until September 1, 1975.

when it ceased actual project construction on September 10, 1975, five months and twenty-one days prior to its having filed for the initial section 53 CCN.[48] In short, it was unclear whether or not the Company ever intended to build the plant. Nevertheless, it pursued the original CCN in Docket Numbers 17 and 41 as though it did so intend.

The Commission ruled in Docket Number 17 that the Company was not entitled to a section 53 certification for the proposed plant based on the evidence in the record. It made the same decision relating to the transmission lines in Docket Number 41. Instead of putting Allens Creek to rest at that point, however, it granted the Company an opportunity to submit additional certification evidence at a later date.[49]

The matters described in Docket Numbers 17 and 41 were subsequently merged and re-opened in Docket Number 88.[50] There, HL&P took the position that it had not abandoned or cancelled its plans to construct Allens Creek in September, 1975, but rather had merely deferred or suspended its construction activities. Under that theory, it argued that it was entitled to an original section 53 certification and it offered as evidence of that fact the argument that after the announced deferral, the Company: (1) did not abandon its efforts to secure a license from the NRC; (2) maintained its major equipment contracts; (3) continued its efforts for obtaining a construction permit from the Texas Water Rights Commission; and (4) made payments to the Brazos River Authority for the water used.[51] The Commission accepted the evidence as offered, and ruled that there had not been an abandonment, and, that HL&P was entitled to a section 53 CCN as requested in the applications submitted in all three Dockets.[52]

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48. *See id.* at 1. The Commission's order relating to the plant was dated August 30, 1976. In Docket No. 41, dated October 8, 1976, the Commission found that Allens Creek and its related transmission lines had been deferred indefinitely. *See id.* at 1.

49. *See id.* at 1.

50. *See id.* at 2.

51. *See id.* at 3.

52. *See* Docket No. 4540, Application of Houston Lighting and Power Company for a Rate Increase, Cities' Brief 7 (Dec. 6, 1982); Docket No. 88, Application of Houston Lighting and Power Company for a Certificate of Convenience and Necessity for the Allens Creek Nuclear Generating Station, Examiner's Report 3 (Jan. 5, 1977). The issue was, in fact, one of first impression for the Commission. The Commission noted that no statute or rule existed which specifically addressed the stituation before them. *See id.* at 7.

When the Company filed its application in Docket Number 4540, it essentially alleged the same arguments proposed in Docket Number 88. Moreover, it had ceased project construction activities and was giving serious consideration to its cancellation. In addition, its posture with respect to the NRC and its licensing process remained unchanged and, as was the case in prior instances, the Company's management choice was a unilateral decision. Unfortunately, the Commission in Docket Number 4540 ignored those similarities in facts as well as its own reasoning and conclusion in Docket Number 88 and found that the Company's conduct amounted to a *de facto* cancellation. In that regard the Commission's judgment was incorrect. While the Company may have been free to exercise unilateral decision-making with respect to Allens Creek in 1975, that power ceased after the 1977 certification. If Allens Creek was to be terminated in 1982, it would require a *de jure* cancellation.

A. *Decertification as a Prequisite for Cancellation*

The Commission had never before been confronted with a *de facto* or a *de jure* cancellation;[53] the closest it came was in Docket Numbers 17, 41, and 88.[54] Prior to January 24, 1977, the Company was not legally proscribed from unilaterally terminating its construction activities. Since the Act was not effective when the project was initiated, there was no certificate to terminate. Moreover, when the Company allegedly suspended or deferred construction on September 10, 1975, it had neither applied for, nor perfected its grandfather application.[55] Therefore, the Company could have chosen not to pursue a section 53 certification and Allens Creek would have died a natural death.

Once it was clear that certification was required by law in order to

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53. *See* Docket No. 4540, Application of Houston Lighting and Power for a Rate Increase, Examiner's Report 48 (Dec. 6, 1982). Although the cancellation issue was not the exact issue involved in Docket Nos. 17, 41, and 88, it appears that the conclusion reached in Docket No. 4540 would have also been reached in the former dockets. *See id.* at 48.

54. *See* Docket No. 88, Application of Houston Lighting and Power Company for a Certificate of Convenience and Necessity for the Allens Creek Nuclear Generating Station, Examiner's Report 1 (Jan. 5, 1977). The Application was filed March 1, 1976. *See id.* at 1.

55. *See id.* at 1. The Company, however, chose otherwise. It knew it would have to certify the project if it wanted to keep the possibility of future construction alive. The PURA was enacted and certification became a prerequisite in both state and federal regulatory schemes. Hence, the Company had no other choice but to pursue the course it did.

"render service directly or indirectly to the public,"[56] it should have been equally clear that those services could not be reduced, impaired, or terminated, except in accordance with applicable law. That was the counter issue presented the Commission in Docket Number 4540. The City of Houston, Baytown, and the Coalition of Original Jurisdiction Cities' (Cities') argued that section 58(b) of the Act placed "an affirmative obligation upon a certificate holder to not discontinue, reduce or impair service until such time as the PUC [had] considered the effect of such action on the public convenience and necessity and established conditions, if any, for such discontinuance, reduction, or impairment."[57] The Commission refused the Cities' contention. It found their position untenable and concluded that "a utility must be contributing in some manner to the 'service' a utility provides before the issues of public harm addressed in § 58(b) even arises."[58]

It required a creative imagination for the Commission to reach that conclusion. Obviously it could not avoid the blatant statutory mandate dicated by section 58(b).[59] Therefore, it had to narrow the crux of the issue in Docket Number 4540 to one of determining "whether [Allens Creek] in [its] present state of completion . . . [could] be described as a 'service' within the meaning of §§ 3(s) and 58(b) . . . ."[60] The Commission concluded that it could not be construed in that manner. That conclusion appeared to have been predicated on the notion that service, as a legal term, was somehow different or intended to be used differently in section 58(b) than in section 50 or section 53. In other words, when service was used in a section 53 CCN application, it was meant to refer to the future, i.e., a facility to be used in providing a future service; but once the project was certified, the term was transformed to mean the actual delivery of service to the public.

The Cities' maintained that the Act provided the appplicable defi-

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56. *See* TEX. REV. CIV. STAT. ANN. art. 1446c, § 50 (Vernon 1980).

57. Docket No. 4540, Application of Houston Lighting and Power Company for a Rate Increase, Cities' Brief 6 (Dec. 6, 1982).

58. Docket No. 4540, Application of Houston Lighting and Power Company for a Rate Increase, Examiner's Report 47 (Dec. 6, 1982).

59. TEX. REV. CIV. STAT. ANN. art. 1446c, § 58(b) (Vernon 1980). Note that "the holder of a certificate shall not discontinue, reduce or impair service to a certified service area or part thereof . . . ." *Id.*

60. Docket No. 4540, Application of Houston Lighting and Power Company for a Rate Increase, Examiner's Report 46 (Dec. 6, 1982).

nitional parameters. They argued that "service" as used in the Act is used in a broad and inclusive sense so that all acts performed, all things supplied, and all facilities used by public utilities in performing their duties would be included in the meaning of "service."[61] The Cities' argument was statutorily defensible. Service was undoubtedly intended to be a term of legal art. Otherwise, the legislature would not have gone to such great lengths to define it specifically in a broad and inclusive sense.[62]

Nevertheless, the Commission insisted on viewing its grant of power myopically in Docket Number 4540. From its perspective, the project was in a stage of infancy. "Land [had] been set aside, preliminary engineering and legal work [had] been accomplished, and some plant equipment [had] been acquired and stored away for safe keeping."[63] Since that was all that had been accomplished, the Commission declined to see how it could regard Allens Creek as a facility that used, furnished, or supplied service in the performance of its duties.[64]

The Commission's interpretation of sections 3(s) and 58(b) was too narrow and strict. Moreover, in this particular instance, it was erroneous. It construed the Cities' application of section 58(b) to literally mean that any and all acts done or performed in the service of the public would require a formal proceeding before they could be discontinued; such is not the case. In fact, the statute itself does not support such a broad application, construction, or interpretation. Section 58(b)(1), (2), and (3) specifically delineate instances where a formal decertification is not required: (1) nonpayment of charges; (2) non uses; or (3) other similar reasons in the usual

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61. Docket No. 4540, Application of Houston Lighting and Power Company for a Rate Increase, Cities' Brief 9 (Dec. 6, 1982); *see also* TEX. REV. CIV. STAT. ANN. art. 1446c, § 3(s) (Vernon 1980). Section 3(s) provides in pertinent part that "service" should be used "in its broadest and most inclusive sense, and includes any and all acts done . . . any and all things furnished . . . and any and all facilities used . . . by public utilities in performance of their duties. . . ." *Id.*

62. *See* TEX. REV. CIV. STAT. ANN. art. 1446c, §§ 3(s), 58(b) (Vernon 1980).

63. Docket No. 4540, Application of Houston Lighting and Power Company for a Rate Increase, Examiner's Report 46 (Dec. 6, 1982).

64. *Id.* at 46. The Commission further concluded that almost all activities HL&P would have undertaken to provide service to certified areas would have to be included in the word "service" if the Cities' rationale was followed to its logical conclusion. If that type of argument was repeated, then HL&P would need to apply to the Commission anytime it wished to abandon or halt service "from any facility, for example, an old substation, or an unused transmission line." *Id.* at 46.

course of business.[65] Nonpayment of charges obviously refers to instances where a consumer fails or refuses to pay for the services received. It would be absurd to expect a utility to apply for a formal decertification in those instances, although it would not be unreasonable to expect some type of institutionalized consumer protection against arbitrary cut-offs by the utility.

Service used in the context of Allens Creek does not fit within any of the section 58(b) exemptions. Rather, it refers to "any and all acts done . . . and all facilities . . . furnished by [the] public utilities in the performance of their duties . . . ."[66] Facilities, as used in that statutory definition, embraces "all the plant and equipment . . . tangible and intangible real and personal property without limitation, and any and all means and instrumentalities in any manner owned, operated, leased, licensed, used, controlled, furnished, or supplied for, by or in connection with the business."[67] As the Cities' pointed out in their brief, "service is defined not only in terms of 'electric power or other utility products,' but it also 'implies a degree of active effort to accomplish a desired end.' "[68] Therefore, when HL&P initially proposed building the nuclear generating plant, it applied for section 53 certification in March, 1976, and refiled for certification in Docket Number 88, each of those acts constituted a service within the meaning of sections 3(s), 50, 53, and 58(b); moreover, its purchases of property and equipment also fell within the meaning of facilities as used in those sections.[69]

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65. *See* TEX. REV. CIV. STAT. ANN. art. 1446c, § 58(b)(1),(2),(3) (Vernon 1980). The same would hold true in instances of non-use. It would be unreasonable to expect that some properties in current service would not deteriorate so that they would no longer be serviceable. Likewise, it would be unreasonable to expect a utility to have to institute formal proceedings each and every time that occurred. Therefore, when, or if, a substation were to become no longer serviceable, or a transmission line no longer useable, a decision to discontinue those services would fall within the purview of subsection 2.

Section 58(b)(3) was obviously intended to exclude from formal decertification those activities which normally and regularly affect the day to day operations of a utility's business. Given the broad and plenary context in which the term service was intended to be used, the legislature did not want nor intend that such activities as the cancellation of vendor services be included in that section of the Act. Thus, it enacted the "course of business" exception.

66. *Id.* § 3(s).

67. *Id.* § 3(n).

68. Docket No. 4540, Application of Houston Lighting and Power Company for a Rate Increase, Cities' Brief 9-10 (Dec. 6, 1982).

69. Docket No. 4540, Application of Houston Lighting and Power Company for a Rate Increase, Examiner's Report 46 (Dec. 6, 1982).

Since the mere act of seeking certification is sufficient to constitute a service, and the purchase of property and equipment evidences the actualization of that objective, it stands to reason that a certificated service cannot be terminated except in a manner prescribed by law. Certainly, HL&P could not terminate a certificated, albeit grandfathered, service unilaterally or at its own convenience. Moreover, since a decision to abandon or cancel a service is not a routine matter it cannot be handled in a generalized fashion. It requires a specialized decertification proceeding which would result in an official finding of fact and a reasoned decision *a priori* to deciding the disposition of a company's assets or liabilities.[70] In other words, it requires a section 58(b) proceeding.

B. *Cancellation or Abandonment*

The terms cancellation or abandonment have thus far been used as though they were interchangeable. To some extent they are. Both, if allowed, would result in the termination or loss of a tangible or intangible service or property. While they share similarity in results, however, their theoretical origins are basically different.

Cancellation is the most general and widely used of the two concepts, and thereby, it is the least cumbersome with which to deal. It

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70. *See* TEX. REV. CIV. STAT. ANN. art. 6252-13a, § 16(b) (Vernon Supp. 1982-1983). The form of notice and hearing is set forth as follows:

> (a) When an application for a certificate of public convenience and necessity is filed, the Commission shall give notice of such application to interested parties and, if requested, shall fix a time and place for a hearing and give notice of the hearing. Any person interested in the application may intervene at the hearing.
>
> . . . .
>
> (c) Certificates of convenience and necessity shall be granted on a nondiscriminatory basis after consideration by the Commission of the adequacy of existing service, the need for additional service, the effect of granting of a certificate on the recipient of the certificate and on any public utility of the same kind already serving the proximate area, and on such factors as community values, recreational and park areas, historical and aesthetic values, environmental integrity, and the probable improvement of service or lowering of cost to consumers in such area resulting from the granting of such certificate.

TEX. REV. CIV. STAT. ANN. art. 1446c, § 54(a), (c) (Vernon 1980). The same standards set forth above would be considered in determining whether the discontinuance of the prescribed service would have an adverse affect on the community. Section 58(b) triggers the need for a decertification hearing, while section 54(a) and (c) prescribe the form and the standards for consideration in the hearing; and section 16(b) of article 6252-13a describes the findings of fact and the nature of the decision and order; and section 13(f) and (h) thereof, details the character of the record.

is predicated on the assumption that a used and useful service or property exists[71] which no longer has a present need, and prudent justification requires its removal. Hence, if the service or property is not within the purview of a section 58(b) exemption, the utility must provide a convincing explanation to support its discontinuance and an affirmance of that decision would have to be based on the rationale that the service or property no longer serves the public convenience and necessity and therefore should be terminated.[72]

Abandonment substantially differs from cancellation in that it allows compensation for a used or useful capital item when that asset is retired from public service for reasons that are out of the ordinary. The theory takes into account those situations which cannot be financially provided for;[73] specifically an abandonment is highly unusual because it is unforeseeable.[74] Were it otherwise, a company would be expected to guard against the occurrence through insurance or some other type of risk mechanism[75] or through the traditional tax and depreciation methods.

The important factors to consider in such an abandonment are (1) that the initial decision to acquire the property was prudent;[76] (2) that the property was used and useful before the abandonment decision; (3) that the event causing the abandonment was unforeseen; (4) that the loss occasioned by the abandonment could not have been guarded or insured against; (5) that other possible methods of reducing the risk were considered, but were of no avail;[77] (6) that the

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71. *See id.* § 40(a).

72. *See id.* § 54(a), (c).

73. *See* 10 C.F.R. § 182(A) (1982).

74. *See* Bruder, *Recovery of Losses on Cancelled Projects: Basic Issues,* 1982 PRACTISING LAW INST. 170.

75. *See In re* Jersey Central Power & Light Co., 44 Pub. Util. Rep. 4th 54, 58-59 (1981). The risk mechanisms approved by the New Jersey Board of Public Utilities included a revolving credit agreement and accelerated amortization of the deferred energy balance. *See id.* at 59.

76. *See In re* Rochester Gas & Elec. Corp., 41 Pub. Util. Rep. 4th 438, 442 (1981). The Commission determined that conduct could be considered prudent if the conduct was reasonable at the time of decision making. Whether or not there was a rational basis for management's judgment is the key in determining prudence; inquiring into the wisdom of the decision is improper. *See id.* at 442.

77. An abandonment might be necessitated by an act of God or some other unforeseeable event. *See In re* The Detroit Edison Co., 20 Pub. Util. Rep. 4th 1, 33 (1977). A severe storm resulted in extraordinary loss; repair costs of $11,161,366 were deemed reasonable and proper under the circumstances. *See id.* at 33. Another example could occur where a major development takes place in the computer industry which obsoletes a company's manage-

rate payers would benefit by the abandonment; and (7) that the facts support the abandonment as a prudent management decision.[78]

Nuclear plant abandonment decisions in instances where the facilities are operational conform more readily to these factors. Where the plants, however, have failed to come on line, such as Allens Creek, the model breaks down. Granted, the initial decision to construct the Allens Creek facility was prudent under the prevailing circumstances. The project had been undertaken "to provide [HL&P's] customers reliable electric services at the lowest practical cost,"[79] and at the time it seemed apparent that nuclear power would be able to produce energy at a cost considerably less than either coal or gas/oil-fired generation.[80]

Beyond the prudence of its initial decision, HL&P's reasoning pattern withered. As circumstances changed between 1971 and 1975, the Company failed to respond accordingly and continued to pour money, time, and energy into the project even though it had effectively deferred or suspended all construction activities. Moreover, after the Company reactivated the project in 1975, it again failed to respond timely to changing circumstances and conditions and, for a second time, deferred or suspended construction activities without officially announcing any intention to seek formal termination.

Ordinarily, a precompleted project would be treated as used and useful only in association with Construction Work In Progress

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ment information system. If the facts support a company not being able to plan for the occurrence, or its not being able to phase out the old system while gradually replacing it with the new technology, or if there are no other viable methods of financially reducing the loss, then the cost associated with the abandonment of the old system might be properly classified as an extraordinary property loss.

78. *See In re* Rochester Gas & Elec. Corp., 41 Pub. Util. Rep. 4th 438, 442-44 (1981).

79. Docket No. 4540, Application of Houston Lighting and Power Company for a Rate Increase, Direct Testimony of R.S. Letbetter 29 (May 25, 1982).

80. *See* Docket No. 4540, Application of Houston Lighting and Power Company for a Rate Increase, Direct Testimony of Don D. Jordan 6 (May 25, 1982). In addition, as Mr. Jordan pointed out:

> While nuclear power . . . was more capital intensive than its alternatives, HL&P's financial condition was . . . [also] different . . . . During the period when HL&P was evaluating Allens Creek as a nuclear plant, long-term 30 year debt could be sold at rates of 7-8%, while equity capital could be raised on advantageous terms because HL&P common stock sold at a substantial premium over book value. Therefore, the factors of relatively low-cost financing, stable and predictable load growth, and concern for fuel supply diversity, led the Company to the decision to commit to the construction . . . .

Id. at 7.

(CWIP).[81] Therefore, the only logical way to justify retaining it in that category would be to construct a theory that once the used and useful status had attached for the purpose of CWIP, that status would remain unaffected if the project were subsequently terminated or abandoned prior to its completion. The fallacy in this theory lies in the very nature of CWIP. Conceptually, CWIP is as complex as it is controversial.[82] Therefore, some consideration must be given to its complex character before proceeding further.

Texas requires utilities to furnish services, instrumentalities, and facilities that are safe, adequate, efficient, and reasonable.[83] That requirement, though directed mainly at current conditions, considerably affects a utility's on-going construction program. It dictates the need for developing corporate game plans which would, at least theoretically, phase in new facilities coincident with future demands. Those game plans, as one utility executive explained, are thought of as "long range strategies that substantially affect the quality and cost of . . . service and the financial reality of the Company."[84] In other words, they define the goal of achieving and maintaining adequate service at the lowest practical cost.

Realistically, it takes years to move a new facility from the planning to the on-line stage. Given that reality, it is impossible for a utility to predict with precise accuracy what the final or actual cost of construction will be. Unfortunately, there are far too many uncontrollable (though in some instances, predictable) variables (e.g., inflation and taxes) which have to be taken into consideration and which directly impact cost; concomitantly, there are the ever-changing social or external costs, such as environmental and safety stan-

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81. *See* TEX. REV. CIV. STAT. ANN. art. 1446c, § 41(a) (Vernon 1980). HL&P's action in terminating, cancelling, or abandoning the project prior to completion raises a question as to whether the project acquired, or could have acquired a used and useful status at some phase during the preconstruction activity. Stated differently, could a facility which fails to come on line, or which is never expected to come on line, ever be considered used and useful?

82. *See In re* Potomac Elec. Power Co., 29 Pub. Util. Rep. 4th 517, 546-48 (1979).

83. *See* TEX. REV. CIV. STAT. ANN. art. 1446c, § 35(a) (Vernon 1980).

84. Docket No. 4540, Application of Houston Lighting and Power Company for a Rate Increase, Direct Testimony of J.D. Guy 2 (May 27, 1982). Reaching that objective is also complex. It requires, among other factors, a consideration of such items as "demand forecast, availability and cost of fuels, costs and construction lead times of new generating units." *Id.*

dards, which also have to be reckoned with and which contribute substantially to cost escalation.

These technical, economic, and legal characteristics create a unique condition in the utility industry. Since a utility "is not free to pick and choose its customers, nor to provide service at a level related to any criterion other than customer demand,"[85] it is forced to engage in a continuous building program. While it must constantly build, however, it is not allowed to include cost of construction as plant inservice until the building is completed.[86] This means that it is technically not entitled to a return on investment until the plant is used and useful. That raises a question as to whether a plant under construction could ever be *useful* to the present rate payers. That results in the likelihood that those rate payers would never have to bear financial responsibility for a plant under construction.

Although CWIP is an accounting procedure that allows compensation to be collected contemporaneously with investment,[87] carrying out that scheme has not been easily accomplished. Before 1973, Pepco and Louisville Gas and Electric were the only two electric utilities that were authorized to include CWIP in their rate base.[88] Other jurisdictions devised various other types of schemes. Arizona, for example, permitted CWIP if the plant went into service within eighteen months subsequent to the test period[89] and Florida allowed it on a case by case basis.[90] Texas permitted its inclusion "where necessary to the financial integrity of the utility . . . at the cost as recorded on the books of the utility."[91] Regardless, "those jurisdictions which have sanctioned the inclusion of CWIP in rate base have done so on a qualified or limited basis."[92]

Associating CWIP, moreover, with a precompletion abandon-

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85. *In re* Potomac Elec. Power Co., 29 Pub. Util. Rep. 4th 585, 594 (1979).
86. *See id.* at 594.
87. *See id.* at 595.
88. *See id.* at 549.
89. *See id.* at 549.
90. *See id.* at 549.
91. TEX. REV. CIV. STAT. ANN. art. 1446c, § 41(a) (Vernon 1980).
92. *In re* Potomac Elec. Power Co., 29 Pub. Util. Rep. 4th 517, 549 (1979). In Texas, CWIP is supposed to be excluded if construction is not completed within two years of the end of the test year. *Letter of Transmittal,* 1978 A.B.A. SEC. PUB. UTIL. L. REP. 38, 79. That policy, however, has been balanced against a corresponding policy of continuing CWIP beyond the two years in order to insure a utility's "ability to continue to raise new capital for

ment is an inappropriate policy. The two theories are diamatrically opposed and incompatible. CWIP is premised on the theory that the facility under construction is "destined for use in the service of the public,"[93] and precompletion abandonment is predicated on the theory that the facility will never be used in public service. There is no way that the two theories can be harmonized. Once a plant has been terminated prior to completion there ceases to be a realizable expectation of it ever coming into being. It must, at that point, forego any of the legal characteristics of used and useful. In other words, when a project is abandoned or terminated during the preconstruction stage, it must not only be removed from the CWIP accounting classification but the very process of its removal also strips it of the used and useful cloak which the statute provides.[94]

As previously noted, when Allens Creek was reactivated in 1977 HL&P was fully aware that the "estimated capital cost [would be] greater than originally projected. . . ."[95] Nevertheless, the Company chose to ignore that fact and instead rationalized that it was not able to foresee the drastic and dynamic changes which would take place in the economic market place from 1976 on[96] or that other factors, such as a prolonged licensing process, active intervention in the regulatory process, and Three Mile Island would occur and dramatically affect its ability to continue toward its construction goals.[97]

The factors which HL&P cited likewise failed to meet the test of prudent decision-making when measured against those that other utilities have cited in similar circumstances. For example, when Detroit Edison decided to cancel its Fermi III project, its decision was

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financing new generating facilities which operate on fuels more abundant than oil and gas." *Id.* at 80.

93. *See In re* Potomac Elec. Power Co., 29 Pub. Util. Rep. 4th 517, 547 (1979).

94. *See* TEX. REV. CIV. STAT. ANN. art. 1446c, § 41(a) (Vernon 1980); *see also In re* Virginia Elec. & Power Co., 44 PUB. UTIL. REP. 4TH 46, 49 (1981) (after cancellation of project no hope that it will ever be used or useful). The abandonment of Allens Creek also failed to meet the test of unforeseeability. It is very unlikely that an event, or set of events, not definable as an Act of God, could occur which would not provide adequate notice to management that a project is in trouble or destined to fail. This is especially true if the trouble occurs during the pre or early stages of construction.

95. Docket No. 4540, Application of Houston Lighting and Power Company for a Rate Increase, Direct Testimony of Don D. Jordan 8 (May 25, 1982).

96. *See id.* at 7.

97. *See id.* at 8.

deemed reasonable and prudent.[98] Unlike Detroit Edison, HL&P did not state conclusively that there were any factors present which had in fact caused the company injury or which were rendering the ACNP an uneconomical undertaking. Rather, the Company argued that if it were allowed to terminate the ACNP under the terms and conditions specified in its application, that is, if it were allowed to start over with 360 plus million dollars, it would not make the same management choices it had made in 1971 or 1976. Instead, it would use that recouped capital investment to accelerate its construction schedule for its Limestone and Malakoff lignite plants by one year.[99] In effect, the Company retained its position up to the last minutes before the Commission hearings that the decision to build Allens Creek was viable[100] and would remain so unless the Commission granted its reinvestment alternative. HL&P's decision, therefore, was not to cancel Allens Creek, but rather, if it were allowed to recoup its entire investment, to abandon the project in its precompletion stage.

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98. *In re* The Detroit Edison Co., 20 Pub. Util. Rep. 4th 1, 33 (1977). The decision was determined to be reasonable in light of such factors as a decreased demand for electrical service, unforeseen obsolescence of the design of the project, and vigorous changes in nuclear licensing requirements which greatly affected the viability and cost of the project. *See id.* at 33.

99. *See* Docket No. 4540, Application of Houston Lighting and Power Company for a Rate Increase, Direct Testimony of Don D. Jordan 13 (May 25, 1982).

100. *See id.* at 11-12; *see also* Docket No. 4540, Application of Houston Lighting and Power Company for a Rate Increase, Direct Testimony of J. D. Guy 8-9 (May 27, 1982). Two alternative plans were considered. One included completion of Allens Creek by 1991 while the other plan would replace Allens Creek with coal capacity. The two proposals were examined against such criteria as rate payer impact and financial soundness. The results of both studies were scrutinized for sensitivity to such changes as fuel prices, estimates of construction costs, equity return, and nuclear plant capacity factors. The conclusions were as follows:

> (1) Allens Creek is minimally justifiable on an economic basis under current planning assumptions.
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> (2) Under assumptions less favorable to nuclear units, the completion of Allens Creek is of little or no benefit.
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> (3) The revene effects on the customer under the coal replacement plan, which included a five-year amortization period for the Allens Creek expenditures with inclusion of the unamortized balance in the rate base, would be approximately the same as under the plan where Allens Creek is continued.

Id.

III. MANAGERIAL DECISION-MAKING AND THE PUBLIC INTEREST

The PURA was passed to ensure that regulated monopolies would conduct their business in the public interest.[101] Compliance with that objective means more than setting a fair rate of return, certifying a facility, or assuring the adequacy of service. It means that the regulated firms are obligated to conduct their transactions in a manner both economically sound and societally responsible. That expectation goes beyond proper company/customer relations or a projected image of good corporate citizenship. Therefore, considering the issues in Allens Creek, one must be as cognizant of how they were presented as of what was substantively proposed. In this respect, the Company's attitude and intent were unmistakably clear. "[W]e have considered alternatives to . . . Allens Creek . . . including its cancellation" Jordan explained, "[and] we are prepared to take that action. . . ."[102] Essentially, Jordan presented the Commission with an ultimatum; give us the rate relief we have requested or suffer the consequences. The Company was firm in its position that if it did not get the rate relief it wanted, it intended to build the plant regardless of its economic feasibility. Such a stance was tantamount to regulatory blackmail.

The Company's position apparently stemmed from its interpretation of the Commission's prior policies of avoiding direct confronta-

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101. *See* TEX. REV. CIV. STAT. ANN. art. 1446c, § 2 (Vernon 1980). Section 2 reads as follows:

> This Act is enacted to protect the public interest inherent in the rates and services of public utilities. The legislature finds that public utilities are by definition monopolies in the areas they serve; that therefore the normal forces of competition which operate to regulate prices in a free enterprise society do not operate; and that therefore utility rates, operations and services are regulated by public agencies, with the objective that such regulation shall operate as a substitute for such competition. The purpose of this Act is to establish a comprehensive regulatory system which is adequate to the task of regulating public utilities as defined by this Act, to assure rates, operations, and services which are just and reasonable to the consumers and to the utilities.

Id.

102. Docket No. 4540, Application of Houston Lighting and Power Company for a Rate Increase, Direct Testimony of Don D. Jordon 5 (May 25, 1982). However, Jordan noted that if the project was terminated without the Company being allowed appropriate rate relief then the Company would be forced to write the investment off against income. "Accordingly, any decision to cancel Allens Creek turns on appropriate action by the Commission to provide for the recovery of the [$362 million] investment . . . through rates." *Id.* at 6.

tion on the issue of nuclear abandonment and allowing utilities to unilaterally decide when it was in the public interest to discontinue a nuclear project.[103]

Causation aside, there were at least two other major points of error and misconception in the Company's assumptions of its power and authority. First, the Company erred in the notion that if it had abandoned the project without first obtaining rate relief, it would be forced to immediately write-off that loss against income; and second, that if the Company failed to receive the rate relief it requested, it could continue its efforts to secure a construction permit.

The initial assumption was based upon a misconception of procedure. Even if it were assumed that an abandonment was permitted by statute or statutory rule-making or that a precompletion abandonment was permissible, a company would still have at least two options prior to its having to write the abandonment loss off against income. Its first option, for example, would be to seek relief through a decertification proceeding. In that situation a utility would have an opportunity to explain in detail the relevant factors which necessitated the abandonment decision; such a proceeding would also provide an opportunity for public participation.[104] If the utility successfully met the burden of proving that the public interest would not be adversely affected by the abandonment or that the abandonment was warranted, the Commission would then be statutorily bound to grant its abandonment request and to order that appropriate relief be granted.[105] The specific amount of that relief would be determined in a subsequent and separate rate proceeding.[106]

The second option would be a request for a special hearing to decide the issue of an appropriate accounting classification in which the abandoned project could be placed. An example of that option was described in *In re The Detroit Edison Co.*[107] In this case, the company petitioned the Michigan Commission to cancel construction of its Enrico Fermi III plant and to authorize a net loss to be

103. *See* Docket No. 2677, Application of Gulf States Utilities Company for Authority to Change Rates (Oct. 12, 1979); Docket No. 2001, Application of Houston Lighting and Power Company for Authority to Change Rates (Nov. 27, 1978).

104. *See* TEX. REV. CIV. STAT. ANN. art. 1446c, § 54(a) (Vernon 1980).

105. *See id.* § 58(b), (c).

106. *See id.* § 58(c).

107. *See In re* The Detroit Edison Co., 20 Pub. Util. Rep. 4th 1, 32 (1977).

amortized over a ten year period.[108] The initial decision was decided in a proceeding termed an "accounting case."[109] The sole purpose of that proceeding was to decide if a loss had occurred, i.e., if the plant could be legally abandoned in its precompleted condition, and, assuming an affirmative finding in the first instance, could the accrued expenditures be accorded a cost of service treatment. The Michigan Commission allowed abandonment but left the specific amount accrued during the development of the project to a later rate proceeding, wherein a decision could be made as to the reasonableness and the prudence of the alleged expenditures.[110]

The Company's second error is more difficult to rationalize. Apparently, its reasoning was keyed to the presumption that a decision to terminate, continue, or abandon a construction project fell exclusively within its managerial discretion. Again, it probably reached that conclusion by interpreting the Commission's past practices.[111]

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108. *See id.* at 32.

109. *See id.* at 32. The Michigan Commission had authorized amortization of the net loss over ten years for accounting purposes. *See id.* at 32. The Commission allowed the abandonment but left the specific amount accrued during the development of the project to a later rate proceeding, wherein a decision could be made as to the reasonableness and the prudence of the alleged expenditures. *See id.* at 32.

110. *See id.* at 32.

111. *See* Docket No. 4540, Application of Houston Lighting and Power Company for a Rate Increase, Examiner's Report 46-47 (Dec. 6, 1982). Note that:

> D.D. Jordan . . . did not want to formally cancel this plant because of advice from lawyers that the NRC proceedings should not be abandoned for fear that the Texas Commission might order HL&P to continue to construct ACNP. Also, the Company wanted some 'assurance' of the regulatory treatment it could expect if ACNP were cancelled. *No* party to this docket has argued that this Commission has the authority to involve itself in utility management to the extent of ordering HL&P to either abandon or to continue to construct ACNP.

Id. at 45-46.

It could be inferred from the Examiner's report that that argument would not have prevailed. The Examiner suggested that the: "objective [cancellation] could be accomplished indirectly through rate making treatment; [even though] HL&P [would have] the right to appeal direct or indirect interference with its management decisions, and would likely prevail if the evidence showed cancellation of ACNP to be a reasonable decision." *Id.* at 45-46.

The Commission has a statutory right under Texas law to assert itself in a utility's management decision in this context. Since certificated service was dealt with, the Commission can exercise its authority pursuant to paragraph 62(a) of article 1446c: "The Commission at any time after notice and hearing may revoke or amend any certificate of convenience and necessity if it finds that the certificate holder has never provided or is no longer providing service in the area, or part of the area, covered by the certificate. . . ." On the other hand, it could mandate a continuation of the project pursuant to section 58(a): "The holder of any certificate of public convenience and necessity shall service every consumer within its certi-

The presumption was incorrect. Notwithstanding past or present practices, the Commission has the statutory responsibility to regulate the conduct of all public utilities in its jurisdiction and to do whatever is necessary under the Act to enforce its jurisdiction.[112] Consequently, only the Commission has the authority to make an actual project termination decision.[113] If the Commission exceeds that authority, the Company has available legal remedies.[114] Thus HL&P's sole managerial discretion was limited to deciding whether it should or should not petition the Commission for a project decertification review.

When HL&P filed its application in Docket Number 4540, it crafted an argument which strongly inferred that Allens Creek should not have been continued. That inference alone was sufficient to trigger that Commission's jurisdiction; moreover, once the specter of imprudence had been raised, a clear dicotomy of interest emerged.

The City of Houston tried to make this point in its brief. It unsuccessfully argued that the PUC had the duty to examine the ramifications of a cancellation of a certified facility on public convenience and necessity prior to the utility's decision to cancel.[115] The city's argument was directed to the appropriate regulatory procedure. In other words, once the issue of a project's continued viability has been brought into question, the Commission is obligated to submit that issue to a section 58(b) review, or if the Commission has reason to believe that the status of a project is dubious, it has a statutory responsibility to initiate a due process proceeding to revoke the CCN on the theory that the certificate holder has not provided or is no longer providing service in the area covered by the certificate.[116] In this latter respect, the Commission acknowledged in Docket Number 4540 that its own staff had been following the Allens Creek issue for years, and that there had been past doubts as to whether

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fied area and shall render continuous and adequate service within the area or areas." TEX. REV. CIV. STAT. ANN. art. 1446c, § 58(a) (Vernon 1980).

112. *See* TEX. REV. CIV. STAT. ANN. art. 1446c, § 16 (Vernon 1980).

113. *See id.* § 16.

114. *See id.* §§ 69, 85.

115. *See* Docket No. 4540, Application of Houston Lighting and Power Company for a Rate Increase, Cities' Brief 13 (Dec. 6, 1982).

116. *See* TEX. REV. CIV. STAT. ANN. art. 1446c, § 62(a) (Vernon 1980).

the project would ever become a reality.[117] The bottom line was that the Company's own management studies had been skewed in favor of continuing the project, a situation that did not meet the test of prudence.[118]

HL&P's managerial decision-making and decorum was inconsistent with the public interest. Though the ultimate decision seemed otherwise, the Commission was of like opinion.[119] In reviewing the proceeding, it reached the conclusion that the Company's overall behavior was "improper and imprudent."[120] The Commission noted that they and customers of HL&P would be "shocked" to learn in the future that a 'cancelled' plant they had been paying for over the years had suddenly 'reactivated' because HL&P had continued to seek NRC licensing of that plant even after rate relief for cancellation of the plant had been afforded at an earlier time."[121]

IV. METHOD OF APPORTIONMENT

Assuming that the abandonment of Allens Creek was a legitimate write-off, designing an appropriate method for apportioning the loss would still present a formidable problem. The method which HL&P proposed in Docket Number 4540 defies imagination. The Company not only asked to recoup 100% of its investment,[122] it also

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117. *See* Docket No. 4540, Application of Houston Lighting and Power Company for a Rate Increase, Examiner's Report 52 (Dec. 6, 1982). Moreover, it had found both sufficient and credible evidence that the Company had ignored available historical data as well as some of the more obvious risks associated with nuclear plants. *See id.* at 52.

118. *See id.* at 52. In fact, the record and facts in Docket 4540 obviously proscribed a continuation of Allens Creek. *See id.* at 32. Consequently, the notion that the company, had it failed to get the rate relief it requested, could nevertheless have continued with the project was erroneous. When faced with a similar situation, the New York Commission ruled that the prudence of an act must be determined in view of the circumstances prevailing at the time each significant decision to pursue a project further is made. *In re* Rochester Gas & Elec. Corp., 41 Pub. Util. Rep. 4th 438, 442 (1981). Therefore, had the Company continued the project under the circumstances described in its prefiled testimony, the Commission would have been obligated to disallow any further investments.

119. *See* Docket No. 4540, Application of Houston Lighting and Power Company for a Rate Increase, Examiner's Report 53 (Dec. 6, 1982).

120. *See id.* at 53.

121. *See id.* at 53. The Commission noted that the "record indicate[d] that this [was] what HL&P had in its mind until the cities and staff put a stop to it by refusing to allow amortization of a plant which, in their opinion, had not been cancelled." *Id.* at 53.

122. *See* Docket No. 4540, Application of Houston Lighting and Power Company for a Rate Increase, Direct Testimony of R.S. Letbetter 24 (May 25, 1982). The Company submitted a proposal for recovery of $362 million of capital invested. That amount represented

asked that it be allowed to recover those expenses "over a 10 year period with a return on the unamortized balance . . . less the accumulated deferred income taxes related to the write-off. . . ."[123] Moreover, it wanted to compute the amortized amount by "using the sum-of-the-years'-digits method,"[124] and the unamortized balance, by "applying the Company's cost of capital to the average balance, net of accumulated deferred income taxes, during the period in which the rates would be in effect."[125] That method would have allowed the Company to recover 73% of its investment, or $263 million, over the first four years of the amortization period.[126] Alternatively, HL&P proposed a recovery of the amortized amount in equal portions over a five-year period.[127]

The Company's proposed methods for recovering the alleged losses were unacceptable for two reasons. First, the requested write-off periods (10 or 5 years under current circumstances) were far too short.[128] One commentator has observed that, while "useless asset[s] should be written off the books as quickly as possible," the actual decisions seem keyed to achieving the write-off "consistent with reasonable impact on rates."[129] He concluded that "the Commission [FERC or the state commission] regards as a reasonable impact or write-off to be at least 1% to 1.5% but not as high as 2% to 3%."[130] It should be noted, however, that in the one instance where a Commission allowed 20 years as a write-off period, the amount requested to be amortized was in excess of $300 million;[131] HL&P's proposed $362 million write-off was projected to be written-off over a four or

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the total, current investment of the Company in Allens Creek minus $26 million for uranium concentrate which could be recovered elsewhere. *See id.*

123. *Id.* at 25.

124. *Id.* at 25.

125. *Id.* at 25.

126. *See id.* at 28.

127. *See id.* at 29.

128. *See id.* at 29.

129. See Bruder, *Recovery of Losses on Cancelled Projects: Basic Issues,* 1982 PRACTISING LAW INST. 176. Write-offs of the magnitude created by the abandonment of nuclear projects are relatively new. Consequently, there are a few definitive standards for determining a precise write-off period. Regulatory commissions seem to have a fair degree of discretion in this respect. However, a trend does appear in the making. Most write-offs have been spread over a seven year period, although, in one instance, twenty years was allowed and in another, only three years was allowed. *See id.* at 176.

130. *Id.at* 176.

131. *See id.* at 176.

five-year period; by comparison, the latter request is extremely unreasonable. Moreover, although the exact extent of the write-off's impact on rates was not known nor given it surely would have exceeded a two to three per cent level.

The Company's proposal for recovering its loss was unreasonable for a second reason in that the return on the unamortized balance would have been a penalty to the rate payer. The Company's write-off period was supposed to approximate the additional time the project would have been included in its construction program.[132] In actuality, that proposition was a sham. The proposed 10 year period was offset by the Company's further proposal to use the sum-of-the-years'-digits method of recovery. Thus, the proposed method of recovery would have reduced the write-off time by approximately six years which would have made the actual write-off period four to five years.

The Company's logic in selecting the sum-of-the-years'-digits method was also questionable. It was premised on a contrived comparable risk model which purportedly assigned the recovery of cost to the periods which would have benefited most from the cancellations,[133] i.e., the earlier stages of construction. Although the chosen method purported to assign costs to the period which would benefit most by the reduction of capital requirements, the sum-of-the-years'-digits method would have been more beneficial to the Company by allowing it to recover three-fourths or more of its investment in half the formally requested time. Hence, the rate payer would have been asked to bare a significantly heavier burden; a risk responsibility which should have been assumed by the Company. Risk is an indicia of ownership, and as one commission has pointed out, the "owners control their companies and assume the risk of ownership by investing . . . rate payers cannot be asked to insulate the owners from all financial risk."[134]

In addition to the amortized recovery, the Company also wanted

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132. Docket No. 4540, Application of Houston Lighting and Power Company for a Rate Increase, Direct Testimony of R.S. Letbetter 26 ((May 25, 1982).

133. *See id.* at 27. The company reasoned that during the early stages of construction, projects are most vulnerable to regulatory change, schedule slippages and cost overruns. As a result, a company suffers higher costs which results in increased costs to rate payers. As a project nears completion, the risks disappear "and the positive attributes of less expensive fuel costs . . . begin to be anticipated." *Id.* at 27.

134. *In re* Northern States Power Co., 42 Pub. Util. Rep. 4th 339, 362 (1981).

a return on its unrecovered investment.[135] Regulatory treatment of the unamortized balance is not a well settled issue nationwide; jurisdictions have tended to be split. For example, the states of California, New Jersey, Texas and Virginia have denied rate base treatment for these changes, while Florida, Louisiana, New York, North Carolina and Wisconsin have allowed their inclusion.[136] Hence, the unamortized balance issue with respect to Allens Creek appears to have been a diversionary tactic. The Company did not realistically expect the PUC to respond favorably to that aspect of its request. It was well aware of the Commission's past practices of not including allowances for the time value of money in the rate base.[137] Moreover, the specific issue relating to Allens Creek was not new. In Docket Number 2001, the Commission had specifically found a return treatment on the unamortized balance was unreasonable, and in Docket Number 2606, it again disallowed approximately $21 million in unamortized cancellation charges associated with the termination of the number two unit and of the amounts advanced to Continental Oil Company for HL&P's participation in a New Mexico uranium development project terminated in 1978.[138] HL&P's rate treatment request was disproportionately weighed in favor of the Company's stockholders; in fact, HL&P did not believe its shareholders should share in any of the alleged losses. Such thinking is contrary to the established regulatory doctrine which requires that rate treatment reflect a balancing of the interest between the Company and the rate payers.[139]

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135. Docket No. 4540, Application of Houston Lighting and Power Company for a Rate Increase, Direct Testimony of R.S. Letbetter 30 (May 25, 1982). The Company advocated that position on the theory that its investors should not be penalized because the project was, at its inception, a prudent undertaking. According to Letbetter, not only would existing bondholders and preferred stock holders suffer a loss because of no return on their investment, but the Company would find it difficult to sell more securities "because of the uncertainties created by such regulatory treatment." The end result to the financial arena would be very negative for failure to recover on a prudent investment. *See id.* at 30.

136. *See* Bruder, *Recovery of Losses on Cancelled Projects: Basic Issues,* 1982 PRACTISING LAW INST. 175; *see also In Re* The Detroit Edison Co., 20 Pub. Util. Rep. 4th 1, 13 (1977) (Michigan disallows rate base treatment).

137. *See In Re* Houston Lighting & Power Co., 36 Pub. Util. Rep. 4th 94, 105 (1980).

138. *Id.* at 105. Of course, the Company had nothing to lose by requesting a return on the unamortized balance. Had the Commission changed its position, the Company would have profited; had the Commission chosen to remain consistent in its practice (which, in fact, it did), the Company would have lost nothing more than what it had expected based on previous experiences.

139. *See* Railroad Comm'n v. Entex, Inc., 599 S.W.2d 292, 295 (Tex. 1980). The court

Part of the problem here is directly tied to the Company's skewed perception of who would benefit by the proposed rate treatment. According to Letbetter, the abandonment of Allens Creek would not be of benefit to the stockholders. As he saw it, if the Company were to continue with its plans "the common stockholder would have the opportunity to earn a return on [that] investment just as he does [on] other plant investments. The cancellation . . . [was] considered because the Company believe[d] that the rate payer [would] benefit and not because the common stockholder [would] benefit."[140] In other words, were the shareholders to accept any of the financial responsibilities associated with the termination, the impact thereof would result in the Company's financial deterioration; should the Company be faced with an unhealthy financial position, its ability to either fund or accomplish a large construction program would be seriously impaired or erroded. Hence, a deteriorated financial stance for the Company would increase financing costs and cause difficulty in procuring external capital; not only would shareholders suffer but also investment in HL&P and Houston Industries Incorporated would come to a halt.[141] The Company translated that rationale as a benefit to rate payers by arguing that an avoidance of a negative financial impact would lead to a financially healthy company which would attract the necessary funds to meet existing and future needs and to maintain adequate services, ergo, the rate payers benefit.

In essence, HL&P developed a theory of regulation rationalizing that whatever is in the best interest of the Company is also in the best interest of the rate payer. It designed its logic and reasoning to continually justify its speculative and imprudent decision-making. Even though it may be legitimate for a company to seek self-interest maximization, it is not reasonable for a company, to consistently disclaim financial responsibility for all its imprudent investment de-

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noted that a "reasonable rate must balance the consumers' desire for low rates against the utility's need to improve and expand." *Id.* at 295.

140. Docket No. 4540, Application of Houston Lighting and Power Company for a Rate Increase, Direct Testimony of R.S. Letbetter 30 (May 25, 1982).

141. *See id.* at 31; *see also* Federal Power Comm'n v. Hope Natural Gas Co., 320 U.S. 591, 603 (1944) (return on investment must be adequate to ensure financial integrity of business in order to keep credit and attract captial). *See generally,* Hunt & Legg, *Public Utility Rates in Illinois: The Bell Cases,* 50 NW. U.L. REV. 17, 40-41 (1955) (utility must attract adequate capital to maintain and improve service).

cisions. "Traditional business practice," as one commission noted, "as well as economic theory, demands that the rate payers not bear [the] entire investment burden. The fact that [a company] is a regulated monopoly does not mean, and has never meant, that the rate payer rather than the investor must bear the investment. . . ."[142]

The Company's move to shift the total financial burden to the rate payer was again motivated by its perception of the Commission's past practices in granting Allens Creek special treatment.[143] Since those practices have never been judicially tested, they are presumed permissible and warranted. Under those circumstances, the Company may have had some justification in believing that the Commission's practice of special treatment would continue to shield it from loss so long as it could continue to construct a reasonable set of conditions which would indicate that the insulation of its stockholders against loss was a necessary incentive for the utility to take reasonable investment risks for the benefit of its rate payers.[144]

On the other hand, it is doubtful that the Commission ever intended its special treatment standard to be used in every situation, especially in the abandonment of a precompleted nuclear facility. At best, the Commission intended that each instance be weighed carefully,[145] which meant that, before it would allow such treatment, it would have to conduct a considered and detailed review of all the facts which allegedly gave rise to the loss. To conclude otherwise would contradict another important incentive, i.e., that of requiring a utility "to exercise well-reasoned, prudent judgment in its business and investment decisions."[146]

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142. *In re* Virginia Elec. & Power Co., 44 Pub. Util. Rep. 4th 46, 49 (1981).

143. *See In re* Houston Lighting & Power Co., 36 Pub. Util. Rep. 4th 94, 120 (1980). In Docket 2001 and after it had cancelled plans to construct a second unit at Allens Creek, HL&P asked the Commission if they could amortize its cancellation charges over a five-year period. "Because this amortization was specifically approved by the Commission in Docket 2001, the examiner here recommends that HL&P's adjustment for this expense be accepted." *Id.* at 121.

144. *See id.* at 121. The examiner noted that:

> [He did]not feel . . . it . . . inappropriate for the Commission to allow a utility to recover selected past investment losses from its ratepayers when the circumstances of the investment, *weighed carefully,* indicate that insulating the shareholders from the losses provides a necessary incentive for the utility to take reasonable investment risks for the benefit of its ratepayers.

Id. at 121.

145. *See id.* at 121.

146. *Id.* at 121.

V. RATE OF RETURN AND ALLOWABLE COST

During the course of Docket Number 4540, the PUC staff asserted the proposition that "section 39 of the Act require[d] the Commission to set rates that recovered all reasonable operating expenses and [to] provide a reasonable return on invested capital."[147] The staff's argument was predicated on the theory that the Act did not place limitations of certification on the exercise of rate-making powers.[148] For instance, despite a plant's certification, expenses resulting from construction or operation of a plant that were found to be imprudent could be excluded from rates by the Commission.[149] On the other hand, reasonable expenses such as those preconstruction facilities incurred before certification could be allowed.[150] In short, the Commission believed that the Act placed no restraint upon it in detemining what were reasonable costs recoverable through rates aside from excessive return, affiliate transactions, and income taxes.[151]

The Commission's assessment of what constitutes permissible expenses under section 39 was shortsighted. It is indeed restrained in what it can classify as reasonable costs. In fact, through statutory rulemaking, the Commission has determined that cost of service should include only those costs which are reasonable and necessary expenses properly incurred in rendering service to the public.[152] Concomitantly, it has specified that those costs have to reflect "operations and maintenance expenses incurred in furnishing normal utility service and in maintaining utility plants used by and useful to the utility in providing service."[153] The expenses associated with a precompletion abandonment do not conform to these standards; nor

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147. Docket No. 4540, Application of Houston Lighting and Power Company for a Rate Increase, Examiner's Report 44 (Dec. 6, 1982).

148. *See id.* at 44.

149. *See id.* at 44-45.

150. *See id.* at 45.

151. *See id.* at 45.

152. *See* Tex. Pub. Util. Comm'n, 16 TEX. ADMIN. CODE § 23.22 (Shepard's Sep. 1, 1982). Section 23.22 states in pertinent part that:

> Cost of Service is equal to that amount of revenue required to cover all reasonable and necessary expenses properly incurred by the utility in rendering service to the public and provide a fair and reasonable return on the adjusted value of invested capital used and useful in rendering such service.

Id.

153. *Id.*

do they conform to any of the other allowable expenses set forth in the substantive rules regarding cost of service.[154]

An almost identical situation to Allens Creek arose in Ohio. The Ohio Supreme Court was faced with the question of whether the state commission could lawfully and prudently permit the Cleveland Electric Illuminating Company (CEI) to treat its investment in four cancelled nuclear generating stations as amortized cost.[155] In a prior hearing, the Ohio Commission had found that CEI had exercised reasonable and prudent decision-making at every step of the construction process and, therefore, should be allowed its proposed amortization.[156] The supreme court, however, disagreed. Grounding its opinion on the two sections of the Ohio statute which mandated the ratemaking formula, the court refused to accept an overly broad construction of the statute.[157] It found that the Ohio Commission's view of the statute was that of "a virtual wild card to be

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154. *See id.*

155. *See* Office of Consumer's Counsel v. Public Util. Comm'n, 423 N.E.2d 820, 825 (Ohio 1981).

156. *See id.* at 826. The Commission noted that the original decision to begin construction was reasonable as based on the available data. *See id.* at 826. The Commission order stated that, " '[s]imilarly, no one disputes that the decision to terminte construction was reasonable, given the intervening decline in growth expectations and uncertainties which now attend the construction of nuclear units.' " *Id.* at 826.

157. *See id.* at 828. The statute on which the court relied provides in pertinent part:

> (D) When the public utilities commission is of the opinion, after hearing and after making the determination under divisions (A) and (B) of this section . . . that the maximum rates, charges, tolls, or rentals chargeable by any such public utility are insufficient to yield reasonable compensation for the services rendered, and are unjust and unreasonable, the Commission shall:
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> (2) With due regard to all such other matters as are proper, according to the facts in each case,
>
> (b) . . . fix and determine the just and reasonable rate, fare, charge, toll, rental, or service to be rendered, charged, demanded, exacted, or collected for the performance or vindiction of the service that will provide the public utility the allowable gross annual revenues under division (B) of this section, and order such just and reasonable rate, fare, charge, toll, rental, or service to be substituted for the existing one.

OHIO REV. CODE ANN. § 4909.15(D)(2)(b) (Baldwin 1982). The language in section 4909.15(D)(2)(b) differs from the Texas statute, section 39 of article 1446c. The latter addresses itself in a plenary fashion to fixing overall revenues at a level which would permit the utility to recover operating expenses together with a reasonable return on invested capital, whereas the former allows recovery in matters that are proper. Nevertheless, in both instances, the language is broad enough that, without more, it could be interpreted as having given both Commissions complete and absolute discretion in rate setting — the only limitations being those imposed by other sections of the statute.

played whenever the commission in its discretion [saw] fit."[158] The court chose instead to interpret the statute less broadly, and held that the Commission could make necessary adjustments to rates according to the statutory formula and thus "smooth out abnormalities in the rate making equation" which might make test-year data misleading for ratemaking.[159]

Section 39, on the other hand, was first reviewed by the Texas Supreme Court in 1978.[160] The court confronted the proposition that sections 39, 40, and 41 of the PURA combined to establish a dual rate base.[161] Both the Texas Commission and the lower courts had held that "section 39 set a *minimum* rate base permitting a reasonable return on 'invested capital' or original cost less depreciation, and sections 40(a) and 41(a) set a *maximum* rate base permitting a fair return on the 'adjusted value of invested capital'."[162] The court rejected that notion. It found that the available legislative history of the two sections prescribed the setting of upper and lower limits on the monetary return allowed to a utility as a return on its investment.[163] It then ruled that sections 39 and 40 were guidelines for the Commission to use in determining whether or not the return to the utility was within the parameters of the sections.[164]

The Texas Supreme Court reiterated its findings in *Southwestern Bell* in *Railroad Commission of Texas v. Entex, Inc.*[165] The court

158. Office of Consumers' Counsel v. Public Util. Comm'n, 423 N.E.2d 820, 828 (Ohio 1981).

159. *Id.* at 828.

160. *See* Southwestern Bell Tel. Co. v. Public Util. Comm'n, 571 S.W.2d 503, 513-16 (Tex. 1978).

161. *See id.* at 513.

162. *Id.* at 513.

163. *See id.* at 514.

164. *See id.* at 514.

165. 599 S.W.2d 292 (Tex. 1980). Once again, the court was faced with the task of interpreting the parameters of sections 39 and 40. This time, the issue arose out of *Entex's* application to the City of Beaumont, Texas to increase natural gas rates. When the City failed to act on the request, the company appealed to the Railroad Commission which eventually granted it a 4% rate of return on its adjusted value of invested capital rate base of $14,005,509. *See id.* at 293. The Railroad Commission determined the Company's rate base through an application of section 41 of the Act. It applied the section in such a way as to strike a balance between original cost depreciated and current reproduction cost less an adjustment for age and condition; the adjusted value being based upon 60 to 75 percent of the original cost less depreciation and 25 to 40 percent current reproduction cost less an adjustment for age and condition. The exact balance between the two percentages was left to its discretion. *See id.* at 293-94.

reasserted the rule that "section 39 provide[d] the 'floor' on the rate of return, i.e. requiring minimum revenues to equal operating expenses plus a reasonable return on original cost less operating expenses plus a reasonable return on original cost less depreciation . . . [and that section] 40(a) [was] the 'ceiling' in that the rate of return could not yield revenues greater than a fair return on adjusted value."[166] Between those two extremes, it ruled that the Commission had the authority to set the rate of return at any level.[167] The court found this approach to be basically pragmatic[168] in that it allowed the Commission to follow section 41(a) to determine rate base, and sections 39 and 40(a) to determine the permissible range for rate of return.[169]

Aside from establishing parameters for sections 39 and 40(a), the holding in *Entex* also established a priority in form or procedure for a rate case. "A proper rate determination," the court held, "requires a consideration of three important factors: (1) the utility's reasonable operating expenses; (2) the rate base; and (3) a reasonable rate of return."[170]

The procedure articulated by the court in the *Entex* case should have had an impact on the procedural method applied to Allens Creek. The court said that the first step was to determine reasonable operating expenses, and the second step was to decide rate base calculation. Procedurally, the PUC is obligated to determine rate base *a priori* to any adjustment for rate of return, which was listed as the third step in the process. The Commission ignored those procedural points when it accepted the staff's recommendation that section 39 provided a carte blanche method for accomplishing whatever it wanted to achieve.

A second, but equally important, aspect of rate of return decision-making was also glossed over in the Commission's haste to justify

166. *Id.* at 294.

167. *See id.* at 294-95.

168. *See id.* at 297.

169. *See id.* at 297.

170. *Id.* at 294. It is essential to note the priority which the court established in dealing with this issue. "First, there must be a determination by the regulatory authority of the utility's reasonable operating expenses." *Id.* at 294. Then, "[a]fter deciding what utility property will be included in the rate base, the next step is the rate base calculation . . . . After the rate base is determined, the regulatory authority determines the rate of return, or the percent of the rate base which will be recoverable in revenues by the utility." *Id.* at 294.

allowing some write-off for the Allens Creek abandonment. As noted earlier, precompletion abandonment expenses must be characterized in a legally acceptable fashion if they are to be added to rate base. The Allens Creek expense could not be made to fit that mold. The *Cleveland Electric* case offers guidance in this area as well. The second part of the Ohio statute delineated the service related costs a utility could recover from its rate payers.[171] The Ohio Commission tried to convince the Ohio Supreme Court that a utility's expenditures could be considered a cost of rendering service even if it failed in fact to achieve that purpose. It predicated its rationale on the theory that the statute required the utilities to maintain for the present and foreseeable future adequate services.[172] The court, however, was not persuaded by that argument and defined the real issue as one arising out of a situation in which the Company was seeking and the Commission was attempting to grant an "amortization as service-related costs of an investment that [had] never provided any service whatsoever to the utilities customers."[173] The court seriously questioned whether the Ohio General Assembly had contemplated the Commission according *that kind* of treatment to *that type* of expenditure.[174] In reaching its decision, the court explained that the statute was intended to take into consideration the normal and recurring expenses a utility would incur while rendering public service during the test year.[175]

The Allens Creek expenditures failed to meet the standards regarding allowable cost for the same reasons as those articulated by the Ohio Supreme Court. Moreover, the expenses failed to meet the minimum cost of service standards set by the PUC itself, or the statutory requirement in section 40(a) which proscribes a regulatory authority from setting "any rate which will yield more than a fair

171. OHIO REV. CODE ANN. § 4909.15(A)(1)-(4) (Baldwin 1982). The statute in pertinent part states that the "public utilities Commission, when fixing and determining just and reasonable rates, fares, tolls, rentals, and charges shall determine: . . . (4) [t]he cost to the utility of rendering the public utility service for the test period . . . ." *Id.* § 4909.15(A), (A)(4).

172. *See* Office of Consumer's Counsel v. Public Util. Comm'n, 423 N.E.2d 820, 827 (Ohio 1981); *see also* TEX. REV. CIV. STAT. ANN. art. 1446c, § 35a (Vernon 1980) (public utility shall provide safe, efficient, and reasonable service and facilities).

173. Office of Consumers' Counsel v. Public Util. Comm'n, 423 N.E.2d 820, 827 (Ohio 1981).

174. *See id.* at 827.

175. *See id.* at 827.

return upon the adjusted value of the invested capital used and useful in rendering service to the public;"[176] or for that matter, section 41(a) which dictates that those "rates shall be based upon . . . property used by and useful to the public utility in providing service . . . ."[177] While an argument could be made to sustain an abandonment loss once a project had come on-line, a corresponding argument could not be made under Texas law if the project is abandoned before completion. Allens Creek never reached a stage where it could be legally characterized as a used by and useful facility or service. The Commission readily acknowledged this fact in Docket Number 4540.[178] As previously noted, it styled the crux of the Allens Creek issue in terms of whether the project in its present state of completion could ever be described as a service and concluded that it could not "be described as in use, or furnishing anything to HL&P's service area under the present state of facts."[179]

The Commission's presumption of authority to consider the abandonment loss as a part of rate base or rate of return was an unwarranted exercise of discretion. Its handling of the matter within the context of sections 39 and 41 was tantamount to a reestablishment of the dual rate base theory, i.e., if the expenses were disallowed under section 41, they could be compensated for under section 39;[180] the Texas Supreme Court in *Entex* had clearly explained that although the rate of return and rate base are "interdependent," they are subject to manipulation by the regulatory authority in order to prevent an inequitable rate which might result from recession or inflation.[181]

The Texas Supreme Court did not intend for the Commission's manipulation to include compensating in one section for those items which it could not allow for in the other. The court's concerns were strictly directed to the inequities which might, from time to time, be caused by economic conditions. The court explained that during

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176. TEX. REV. CIV. STAT. ANN. art. 1446c, § 40(a) (Vernon 1980).

177. *Id.* § 41(a) (Vernon Supp. 1982-1983).

178. Docket No. 4540, Application of Houston Lighting and Power Company for a Rate Increase, Examiner's Report 46 (Dec. 6, 1982).

179. *See id.* at 46.

180. *See id.* at 44-45.

181. *See* Railroad Comm'n v. Entex, Inc., 599 S.W.2d 292, 294 (Tex. 1980). *See generally,* Webb, *Utility Rate Base Valuation in an Inflationary Economy,* 28 BAYLOR L. REV. 823, 828-33 (1976) (impact of inflation on utility ratemaking).

inflation a lower return rate should be used to offset the inflated rate base computed on a fair value approach.[182] An original cost depreciation approach, however, would demand a higher rate of return in order for the utility to recover a reasonable amount.[183]

Clearly, abandonment or cancellation expenses are not the type of expenditures which were intended to be manipulable for rate of return purposes. Moreover, the Commission could not accomplish indirectly that which it could not accomplish directly.[184] It is doubtful that the legislature had that purpose in mind when it enacted those sections into law; furthermore, the current legislature has taken steps to re-write section 39 to clarify its intent.[185] It is clear from the amended language in section 39 that the legislature did not intend to grant absolute discretion to the regulatory authority in setting the overall revenue level. The language in amended section 39 reiterates the applicability of the used and useful doctrine to the rate of return standard. In addition, it delineates other essential factors which are to be considered in making that determination such as the quality of the utility's management.

Strictly speaking, public utility commissions are creatures of their state legislatures. They may not exercise any power beyond those specifically granted in their enabling legislation.[186] That principal alone, however, has not been sufficient to prevent many of these agencies from authorizing utility conduct which, under the most narrow construction, would be inconsistent with the enabling stat-

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182. *See* Railroad Comm'n v. Entex, Inc., 599 S.W.2d 292, 294 (Tex. 1980).

183. *See id.* at 294.

184. *See* First Fed. Sav. and Loan Ass'n v. Vandygriff, 639 S.W.2d 492, 496 (Tex. App.—Austin 1982, no writ).

185. *See* Public Utility Commission-Continuation, Powers, Duties, and Administration, ch. 274, § 39, 1983 Tex. Gen. Laws 1258, 1296. Senate Bill No. 232 rewrote Section 39 to state:

> (a) In fixing the rates of a public utility the regulatory authority shall fix its overall revenues at a level which will permit such utility a *reasonable opportunity* to *earn a* reasonable return on its invested captial *used and useful in rendering service to the public over and above its reasonable and necessary operating expenses.*
>
> (b) In fixing a reasonable return on invested capital, the regulatory authority shall consider, in addition to other applicable factors, efforts to comply with the state wide engery plan, the efforts and achievements of such utility in the conservation of resources, the quality of the utility's operations, *and the quality of the utility's management.*

Public Utility Commission—Continuation, Powers, Duties, and Administration, ch. 274, § 39, 1983 Tex. Gen. Laws 1258, 1296 (emphasis indicates added material).

186. *See* Office of Consumers' Counsel v. Public Util. Comm'n, 423 N.E.2d 820, 828 (Ohio 1981).

utes. Moreover, presumption favors the validity of an administrative agency's actions[187] and its decisions stand with the force and effect of law. Over the years, for example, the PUC has accepted the notion of write-offs; it has presumed and acted as though it had the power to allow write-offs as part of a rate case.[188] Heretofore, actual write-offs have been part of negotiated settlements. Docket Number 4540 was the first instance wherein the Commission's power to consider the issue was adjudicated. In all probability this matter will not be settled until either the Texas Supreme Court or the legislature acts upon it. That does not alter, however, the fact that the Commission's prior and present actions have not been legitimate. Aside from statutory rulemaking a commission may not legislate in its own right.[189]

Companies like HL&P that are entangled in predicaments such as Allens Creek are definitely confronted with the possiblity of substantial losses. Undoubtedly, those lossess could seriously affect their financial integrity. Without explicit statutory authority, there is little a utility commission can do, other than turn to the legislature.[190] An economic solution for a nuclear plant abandonment, especially in its pre-completion stage, is not to be found in the context of ratemaking. It is a policy issue that must be addressed in the appropriate forum.

VI. ABANDONMENT EXPENSES AND THE PURA

The PURA does not *per se* proscribe the write-off of general abandonment expenses. Such expenditures may well have been within the contemplation of the legislature when it enacted section 41(c)(3) of the Act.[191] If that were the case, however, it must also be reasoned that the legislature did not intend for the Commission to

187. *See* Board of Adjustments v. Leon, 621 S.W.2d 431, 434 (Tex. Civ. App.—San Antonio 1981, no writ).

188. Docket No. 2001, Application of Houston Lighting and Power Company for Authority to Change Rates 548-49 (Nov. 27, 1978).

189. *See* Office of Consumers' Counsel v. Public Util. Comm'n, 423 N.E.2d 820, 828 (Ohio 1981).

190. *See id.* at 829. The Ohio Supreme Court explained that in the absence of "explicit statutory authorization . . . the Commission may not benefit the investors by guaranteeing the full return of their capital at the expense of the ratepayers." Id. at 829. It would seem that since the Ohio and Texas statutes are similar in this regard, HL&P does not have the necessary authority to recover the losses of their investors at the expense of their ratepayers.

191. *See* TEX. REV. CIV. STAT. ANN. art. 1446c, § 41(c)(3) (Vernon 1980).

exercise complete discretion in determining what expenses would be allowed as abandonment.

Under Texas law, the Commission is required to separate or allocate "cost of facilities, revenues, expenses, taxes, and reserves. . . ."[192] Within that context, its authority is statutorily restrained with respect to transactions between affiliated interest and income taxes.[193] By the same token, it is granted specific statutory authority to promulgate reasonable rules and regulations with respect to the allowance or disallowance of certain expenses;[194] and given its other statutory limits,[195] the Commission is thereby obligated to "make and enforce rules reasonably required in the exercise of its powers and jurisdiction. . . ."[196] Administratively, the Commission must decide what the other certain expenses are to be and to provide for them through the proper process. Hence, one issue with respect to Allens Creek, assuming arguendo that abandonment or cancellation expenses are not proscribed by the used and useful doctrine, is whether the Commission can properly use the ratemaking forum to promulgate abandonment rules.

Abandonment and/or pre-completion abandonment expenses are

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192. *Id.* § 41(b).

193. *See id.* § 41(c)(1).

194. *See id.* § 41(c)(1); *see also* Suburban Util. Corp. v. Public Util. Comm'n, 652 S.W.2d 358, 362 (Tex. 1983). The Texas Supreme Court addressed the issue of disallowance. The court noted that:

> The effect of [the] policy of 'disallowance' is to charge the expense in question to the utility's stockholders instead of to the ratepayers. Such a policy, however, is not without hazard. Under the cost of service method of regulation, the disallowance of certain expenses results in the reduction of the return earned on the rate base. To the extent that the return is diminished by disallowed expenses, the credit standing of the utility may be weakened, a fact which would be reflected in terms of the ease of obtaining necessary financing or attracting new investors. Under Section 39 of the PURA, a utility must be allowed to recover its operating expenses together with a reasonable return on its invested capital . . . . This requirement is met only if the return is sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital . . . . Therefore, it is important that regulatory agencies do not arbitrarily disallow expenditures. If the expense can be shown to be actual, necessary and reasonable it should be allowed.

Id. at 362-63. The reverse is also applicable because it is *important* that regulatory agencies do not arbitrarily allow certain expenses, the legislature specifically provided that those type of expenses are to be determined by rule making.

195. *See* TEX. REV. CIV. STAT. ANN. art. 1446, § 30 (Vernon 1980). Only those costs which are determined to be in the public interest will be allowed for rate-making purposes. Moreover, legislative-advocacy costs will not be allowed for rate-making purposes. *See id.*

196. *Id.* § 16.

issues of rulemaking and not of ratemaking adjudication. While the general rule in administrative process may be that an agency is free to make a decision according to its informed discretion either by general rule or by *ad hoc* adjudication,[197] that rule is not without qualification. For example, one Texas court has noted that when numerous people are subject to substantial administrative action, the rulemaking procedures of an agency are highly advantageous.[198] The court indicated that where an agency is faced with "the alternative of proceeding by rulemaking or by adjudication, the process of rulemaking should be utilized except in those cases where there is danger that its use would frustrate the effective accomplishment of the agency's functions."[199]

The Commission's functions would not have been frustrated had it decided not to act upon the Allens Creek expenditure issue. Considering the eventual outcome, i.e., the actual disallowance of a great portion of the expenses,[200] the Commission could have chosen

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197. *See* State Bd. of Ins. v. Deffenbach, 631 S.W.2d 794, 799 (Tex. App.—Austin 1982, writ ref'd n.r.e.). This is known as the *Chenery* doctrine. *See* Securities Exch. Comm'n v. Chenery Corp., 332 U.S. 194, 203 (1947). In *Chenery,* the United States Supreme Court noted that administrative agencies deal with unforeseeable and specialized problems and that in order to deal with such problems effectively and not stifle the administrative process, and agency must be free to deal with situations either by individual order or general rule. *See id.* at 202. Otherwise, effective administration of a statute would be impossible. *See id.* at 202.

198. *See* State Bd. of Ins. v. Deffenbach, 631 S.W.2d 794, 799 (Tex. App.-Austin 1982, writ ref'd n.r.e.).

199. *Id.* at 799.

200. *See* Docket No. 4540, Application of Houston Lighting and Power Company for a Rate Increase, Examiner's Report 53 (Dec. 6, 1982). In reaching her decision, the examiner noted the following:

> [She was]aware that the test year . . . ended March 31, 1982, and that the recommended exclusion of expenses at ACNP extend[ed] to August 26, 1982, the actual date of cancellation. The examiner believe[d] that the rate payers should not compensate HL&P for poor management performance in this instance, and that the most logical approach to relieving ratepayers of this burden is to exclude expenses associated with the period during which HL&P has been found to be at fault. The examiner [found] that [that] period extend[ed] from January 1, 1980, to August 26, 1982, . . . these factors taken together clearly justify the exclusion of cost . . . of some $160 million from staff's total figure to be amortized over ten years.

Id. at 53-54. In addition to adopting the examiners recommendation for excluding $166 million in expenditures, the Commission also found that: "[b]ecause the evidence . . . establishe[d] that HL&P [had] been imprudent in its management . . . HL&P should be penalized by lowering its return on common equity by 5% to 16.35%." Docket No. 4540, Application of Houston Lighting and Power Company for a Rate Increase, Final Order 1-2 (Dec. 6, 1982). Moreover, it ordered HL&P to pass through to ratepayers, "in its annual rate

to sever the cancellation/abandonment question completely, and taken it up in a rulemaking proceeding. But more importantly, the Commission, in choosing to deal with the issue, ignored the statutory requirement that the other expenses, those not specifically prescribed or proscribed by statute, be determined by rulemaking.[201] Thus, the Commission failed to comply with correct administrative and regulatory procedure.

The PURA does not vest the PUC with the express authority to allow for abandonment or cancellation expenses; rather, it provides the Commission with plenary powers regarding certain expenses.[202] Consequently, the PUC like the Insurance Commission, is also prohibited form sitting "like a Kadi under a tree dispensing justice according to considerations of individual expendiency."[203] Instead, it is obligated to act in accordance with its statutory mandate to promulgate legislative rules which would establish new substantive provisions within the boundaries of the enabling legislation, and which would have authoritative force if within its delegated power.[204] In

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filings, all recoveries associated with the Allens Creek Nuclear Project, including all amounts for equipment sold, and costs avoided through negotiation of existing contracts, or other arrangements. [Those] recoveries are to be used to reduce the unamortized balance of approximately $195 million." *Id.* at 5.

201. *See* TEX. REV. CIV. STAT. ANN. art. 1446c, § 41(1)(c)(3) (Vernon 1980). The court specifically dealt with the procedural appropriateness of rulemaking in *Deffenbach.* William Deffenbach, a credit insurance agent, brought a suit for declaratory judgment to challenge rules which the State Board of Insurance had promulgated dealing with credit life and health and accident insurance. The Board had published notice of various credit insurance rules which were proposed for adoption and sent copies of the proposed rules to one hundred and seventy-six insurers and other interested persons. It then issued an order creating presumptive rates which basically reduced the amount of permium paid for credit insurance. The district court in reviewing the Board's actions decided that the Board's order was actually ratemaking and thus should have been dealt with in a contested case proceeding instead of a rulemaking proceeding. *See* State Bd. of Ins. v. Deffenbach, 631 S.W.2d 794, 796 (Tex. App.—Austin 1982, writ ref'd n.r.e.). A reverse of the *Deffenbach* argument is applicable to Allens Creek where the Commission's order was tantamount to rulemaking rather than ratemaking. The court, however, found in *Deffenbach* that the Insurance Board acted properly in conducting the matter as a rulemaking hearing. *See id.* at 800. It held that a rule, by definition, was an agency statement of general applicability that implements, interprets, or prescribes law or policy. *See id.* at 800 (quoting TEX. REV. CIV. STAT. ANN. art. 6252-13a, § 3 (7) (Vernon Supp. 1982-1983). Therefore, rulemaking was the appropriate vehicle for accomplishing the Board's objective.

202. *See* TEX. REV. CIV. STAT. ANN. art. 1446c, §§ 27, 28 (Vernon 1980).

203. Terminiello v. City of Chicago, 337 U.S. 1, 11 (1949) (Frankfurter, J., dissenting).

204. *See* First Fed. Sav. and Loan Ass'n v. Vandygriff, 639 S.W.2d 492, 498-99 (Tex. App.—Austin 1982, no writ). Rules which possess these characteristics have the force and effect of statutes. "They are binding upon all concerned, including the judicial department,

other words, the PUC is required to legislate before it can adjudicate, and that means it has to follow the appropriate procedures.

Those rulemaking procedures are set forth in section 5 of the Administrative Procedure and Texas Register Act.[205] They differ substantially from those governing the conduct of a contested case, which include ratemaking.[206] This is especially true with respect to the notice requirements. As the court explained in *Deffenbach,* the basic purposes of the notice requirements in rulemaking are to inform the public of proposed rules and to provide adequate notice of the contents of the rule so that they may determine whether or not their interest requires a hearing and their participation.[207] These requirements are extremely beneficial in that they allow and enhance the public's participation in the entire rulemaking process.

Ratemaking fails to take either the policies or purposes of rulemaking into account when dealing with the issues of appropriate charges. Therefore, it is not a suitable substitute for rulemaking, even though, those issues may be raised and deliberated. Nor is ratemaking a proper forum for deciding what is a legitimate type of expense. That too is the proper subject of rulemaking. Ratemaking is applicable only in determining if, once a rule has been promulgated, the standards are met with respect to the reasonableness of the alleged expense.

VII. NUCLEAR ABANDONMENT OR CANCELLATION: ACCOUNTING PROCEDURES

When asked to explain the line entitled "Recovery of Nuclear Plant Cost," Rick L. Campbell, HL&P's manager of Accounting Services, testified that, for the purpose of Docket Number 4540, the 1200 MW unit proposed for Allens Creek was assumed to be cancelled and that the Company's investment to date was "reclassed out of construction work in progress and reclassified to Account 182, Extraordinary Property Loss."[208]

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provided the rule is (a) reasonable, (b) within the power delegated to the agency, and (c) the product of proper procedure." *Id.* at 499.

205. *See* TEX. REV. CIV. STAT. ANN. art. 6252-13a, § 5 (Vernon Supp. 1982-1983).

206. *See id.* § 3(2).

207. *See* State Bd. of Ins. v. Deffenbach, 631 S.W.2d 794, 800 (Tex. App.—Austin 1982, writ ref'd n.r.e.).

208. *See* Docket No. 4540, Application of Houston Lighting and Power Company for a Rate Increase, Direct Testimony of Rick L. Campbell 16-17, 22 (May 25, 1982).

Under some circumstances, section 182 of the Uniform System of Accounts might be an appropriate classification for utility losses. In his text on public utility accounting, James E. Suelflow commented that:

> From time to time most public utilities experience extraordinary losses to property and plant: they usually occur as the result of unforeseen circumstances against which the utility cannot protect itself beforehand with insurance, property or full depreciation, or other reserves.[209]

Accordingly, he noted that the most common causes of such losses were storm damage and technological and regulatory change.[210] Hence, by statutory definition an abandonment or cancellation loss cannot be accounted for in an ordinary or normal fashion.[211] The Federal Power Commission interpreted section 182 as a loss which "exceeds approximately five percent or income computed before the loss."[212]

Where extraordinary loss is occasioned, the key regulatory issues tend to center around insufficient returns to absorb the losses through net income and insufficient depreciation.[213] The Minnesota Supreme Court has provided an excellent summary of those guiding principles for both accounting and regulatory purposes.[214] Whether or not the loss due to obsolescence should be charged to the customer or investor involves two issues. First, a future customer may not be burdened with recovery of a prudent investment, and, second, if such a loss has resulted, it is improper to charge the customer

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209. Suelflow, *Public Utility Accounting: Theory and Application,* MICH. STATE UNIV. PUB. UTIL. STUDIES 72 (1973).

210. *See id.* at 72.

211. *See* 10 C.F.R. § 182(A) (1982). Section 182(A) states in pertinent part:

> When authorized or directed by the Commission, this account shall include extraordinary losses on property abandoned or otherwise retired from service which are not provided for by the accumulated provision for depreciation or amortization and which could not reasonably have been foreseen and provided for and extraordinary losses, such as unforeseen damages to property, which could not reasonably have been anticipated and which are not covered by insurance or other provisions.

Id.

212. Suelflow, *Public Utility Accounting: Theory and Aplication,* MICH. STATE UNIV. PUB. UTIL. STUDIES 72 (1973).

213. *See id.* at 73.

214. *See* Minneapolis St. Ry. Co. v. City of Minneapolis, 86 N.W.2d 657, 666-68 (Minn. 1957).

when the investor has recovered his costs for risk of obsolescence.[215] In addition, when obsolescence has resulted in actual loss, it is reasonable to apportion half of that actual loss to the investor and amortize the other half as an operating expense and charge it to future customers.[216]

Obviously there are no absolute prohibitions against write-offs or extraordinary losses. Utilizing these methods for managerial purposes, however, should be approached cautiously. Both require an application of standards and guidelines.[217] In the instance of Allens Creek, those guidelines were not followed nor were the standards properly applied. A Commission may not change the character of a property by administrative fiat or arbitrarily decide to switch properties among accounting classifications.

Allens Creek did not meet the test of abandonment. Nor did it qualify as an extraordinary property loss. At best, it was a pre-completion cancellation. Consequently, there were no expectations that it would be placed into public service or retired therefrom.

VIII. CONCLUSION

The regulatory treatment accorded Allens Creek raised administrative and regulatory process issues which had not heretofore been directly addressed by the PUC. From an administrative perspective, the threshold issues were ones of ripeness and proper forum; from a regulatory process perspective, they were ones of authority and procedure. While both perspectives retain their distinctive character with respect to ripeness and authority, they tend to merge and become less identifiable with respect to proper forum and procedure.

Both the Company and the Commission believed the fate of Allens Creek could be properly dealt with in a rate proceeding. Without additional facts they may have been correct. There was, however, a regulatory history upon which to draw and from which guide posts could have been found. Had those guide posts been fol-

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215. *See id.* at 666-68.

216. *See id.* at 668. It should also be noted that the Uniform System of Accounts was developed and adopted to serve strictly as an accounting procedure. As such it should not be used as a means for substantively defining what type of property or which items have been abandoned or retired from service. That is a factual determination which the Commission must make from the data made available to it.

217. *See In re* Rochester Gas & Elec. Co., 41 Pub. Util. Rep. 4th 438, 442-44 (1981).

lowed, the Commission might have reacted with more acumen to what the Company was attempting to accomplish.

For whatever reasons, the Commission deliberately chose to pursue an unyielding posture in its persistence that it could conduct Docket Number 4540 in whatever manner it deemed necessary to fulfill its own objectives. Given that regulatory rationale, it chose to ignore the facts that were presented and to construct a scenario of its own. Hence, the thrust of this inquiry has been directed more at how those regulatory objectives were sought than at what those objectives were or whether they were proper. There is no question that the Company and the Commission wanted Allens Creek terminated. The only issue was how the termination was to be carried out and in what forum.

The Company and the Commission assumed Docket Number 4540 was the correct forum because rate proceedings had been used in the past for cancellation and write-off purposes. Their assumption was incorrect. Although the Commission has broad and plenary powers, the fact remains that Allens Creek was a certificated service, and under Texas law, a decertification proceeding is necessary to terminate a certificated service.

It is arguable that once information and data that a facility or service should be discontinued is produced, the regulatory authority is statutorily obligated to deal with the matter. In that situation it would be permissible to deal with the certification issues concurrent with a consideration of proposed rates. Such a situation might even warrant the regulatory authority treating the facility or service as though it were terminated. Should that be the case, however, the regulatory authority's concurrent treatment could only extend to a determination that the test year expenses associated with the facility or service were not *just and reasonable.* That strategy would allow the regulatory authority an opportunity to make a disposition of the expenditures incurred during that test year without having to address the question of decertification and the expenses associated with it. In other words, once the facts are available, the Commission can reach the decision that, for the test year in question, the expenses incurred in connection with the cancelled or abandoned project are not prudent and, therefore, are not allowable as operating expenses or includable in rate base as CWIP. If this strategy were followed in a rate proceeding, the Commission would notify the

utility of its intent to revoke the CCN.[218]

The only alternative strategy which would allow the Commission to deal with a decertification within the context of a rate proceeding would be for the Company to actually or constructively request a dual proceeding. Technically, there is nothing in the Act which would proscribe that form of action, and characteristically, Allens Creek comes close to fitting that model. The Company presented the information and data and asked the Commission to act thereon. The information and data indicated that the project should have been terminated prior to the Company filing for a change in rates. In other words, there was a constructive request that the project be decertified concurrently with the granting of rate relief.

For that scenario to have worked, however, the regulatory authority would have had to have had exclusive jurisdiction over both rate determination and the decertification. A telephone rate change and decertification would best fit that description. In such an instance, the Commission possesses exclusive statutory authority to set the rates and to certify/decertify a service.[219] But the Commission does not have that authority in all situations, and it did not possess that exclusive authority in Docket Number 4540.

If a company files a statement of intent which actually or constructively requests a certification or decertification decision which would have an impact on rates, the application itself would be sufficient to oust the local regulatory authorities of their jurisdiction over that aspect of the rate change request. At best, the local regulators could only exercise authority with respect to the data and proposed changes which affected rates during the test year. Their decision would have to be restricted to the effects of prudent economic decision-making. Hence, the Commission erred in its rationalization

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218. *See* TEX. REV. CIV. STAT. ANN. art. 1446c, § 62(a) (Vernon 1980). The notice would extend to all interested parties and a proper hearing could ensure affording all concerned an opportunity to be heard. *See id.* § 62(a).

219. *See id.* § 62(a). The Commission shares jurisdiction with local regulatory authorities in rate determination matters, but it retains exclusive jurisdiction in certification/decertification matters. *See id.* §§ 16, 17. Therefore, should it act on both matters concurrently, it would effectively deprive the local authorities of their ratemaking jurisdiction. By the same token, section 43(a) of the Act, which requires a company to file its statement of intent with all of the regulatory authorities having original jurisdiction, also mandates that the company's statement specify every proposed change, the effect of those changes on the revenues of the company, and the number of consumers affected. *See id.* § 43(a) (Vernon Supp. 1982-1983).

that: "[t]he Cities' [had] received substantial information on ACNP through the discovery process, and [had] 'considered' ACNP to the extent that they chose to ignore it . . . [or, that] the Cities' could have concluded that ACNP was cancelled for ratemaking purposes and given it the ratemaking treatment the Cities' deemed proper."[220]

The Cities' did not have a choice; they were statutorily barred from concluding or treating Allens Creek as though it were cancelled for ratemaking purposes. The Cities' did exactly what they had to do.[221] They treated Allens Creek as though it were not a timely issue, and by so doing, disallowed any rate treatment of its associated expenses. Under the circumstances of a section 43(a) filing, the local regulators could not deal with the issue of termination until the PUC had had an opportunity to act on the question of decertification. Consequently, they could not determine the reasonableness of any attendant cancellation costs when the project had not been officially cancelled. Likewise, section 43(a) required the cancellation to be *a priori* in order that all the regulatory authorities could have notice of the precise and exact data which would support the utility's proposed changes and their subsequent financial impact. If the Commission were to allow a utility to amend its section 43(a) statement for appeal purposes after a local regulatory authority had heard its original jurisdiction case, then that decision would have the affect of nullifying any order which the local regulators would make based on the original data.

It is very unlikely that the appeals process was intended to include information and data different from that which was competent and available to the original jurisdiction regulators. De novo appellate agency review assumes that: (1) all the regulating bodies have dealt with the same facts, data, and issues; (2) they were all legally competent to act on the requests in the filed application; and (3) the deciding authority acted beyond its jurisdictional or statutory scope in

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220. Docket No. 4540, Application of Houston Lighting and Power Company for a Rate Increase, Examiner's Report 48 (Dec. 6, 1982).

221. *See id.* at 48. The Examiner noted that:

> the fact that the Cities' chose not to develop facts on ACNP which were capable of being fully tried during the Cities" respective hearings does not prevent the Commission from considering all relevant evidence on those same facts in the *de novo* appeals. Furthermore, the Cities" rate ordinances are not binding upon this Commission, in a *de novo* appellate review. The record shows that the evidence of intent to cancel ACNP was before the Cities' in their rate determination.

Id.

reaching its decision and in fashioning its order.[222] Under those conditions, section 26(e) authorizes the Commission to "hear such appeal de novo and by its final order . . . fix such rate as the municipality should have fixed in the ordinance from which the appeal was taken."[223] It is most unlikely that the legislature intended to grant the Commission authority to review a municipal order using information and data that was not available to the local regulators, or that was outside their jurisdictonal competence. If new and different material could be used, then the statutory authority and requisites pertaining to local ratemaking would be completely frustrated.

Judicial recognition of this proposition has been slow in materializing. The court of appeals in *Public Utility Commission v. J.M. Huber, Corp.*,[224] may have opened the door for a more considered look at the impact and implications of de novo appellate review. The ostensible issue in *Huber* revolved around two different interpretations of the Commission's conclusions of law that reducing the rates of some customers belonging to a single class without making adjustments for all other customers was certainly not in the public interest.[225] It was Huber's contention that the Commission's conclusion of law meant that the city of Marble Falls could not change the electric rates paid by the customers within its municipal limits unless the rates paid by the customers of Pedernales outside the municipal limits of Marble Falls were changed concurrently; and because the city was jurisdictionally powerless to compel changes outside its municipal boundaries, the effect of the Commission's conclusion of law was to deprive the city altogether of its exclusive original jurisdiction.[226]

Pedernales, on the other hand, contended that the Commission's conclusion of law should be interpreted as holding invalid Marble

222. *See* TEX. REV. CIV. STAT. ANN. art. 6252-13a, § 19 (Vernon Supp. 1982-1983).

223. TEX. REV. CIV. STAT. ANN. art. 1446c, § 26(e) (Vernon 1980).

224. 650 S.W.2d 951 (Tex. App.—Austin 1983, no writ). The T.M. Huber Corporation, owners and operators of a subsidiary rock-crushing plant located within the municipal limits of Marble Falls, Texas, and purchasers of electrical power from Pedernales, a public utility that served Marble Falls, intervened in and appealed a decision of the PUC on the theory, among others, "that the order perpetuate[d] a prohibited discriminatory rate system and [had] the practical effect of depriving Marble Falls of the exclusive original jurisdiction over electrical rates granted the city by the terms of PURA § 17(a)." *Id.* at 954.

225. *See id.* at 953.

226. *See id.* at 956-57.

Falls' rate ordinance on the theory that the municipality could not reduce the rates of customers in one rate class within the city without adjusting concurrently the rates charged other customers in the same class within the city, and the rates of other intra-city customers in other affected classes.[227]

The court chose not to deal with the specific substantive issues raised by either Huber or Pedernales.[228] Instead, it concentrated on the procedural issue which Huber raised,[229] i.e., does section 26(e) of the PURA grant the Commission discretionary authority to substitute its decision-making for that of the local regulatory authority when the two regulatory bodies have reached different rate decisions. In that procedural context, the court held that the Commission's appellate authority to examine municipal rate ordinances and their ability to fix rates for municipalities are clear from a full reading of the Act.[230] The court concluded that the Commission has the authority to change a municipal rate, but only after a reasonableness review. In other words, the Commission must determine if the local regulatory authority met the just and reasonable standard in reaching its initial original jurisdiction decision. If the local regulatory authority did not act in a just and reasonable manner, then the Commission could "fix the rate the governing body should have fixed based upon the *Commission's* determination of what [was] a reasonable allocation of system-wide data to the rate base, expenses, investment, and rate of return attributable to the utility's service within municipal limits."[231]

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227. *See id.* at 956-57.

228. *See* Public Util. Comm'n v. J.M. Huber Corp., 650 S.W.2d 951, 957 (Tex. App.—Austin 1983, no writ). The court concluded that it was unnecessary to decide if the interpretations of the Commission's conclusions of law were correct. *See id.* at 957.

229. *See id.* at 957. "[W]e must sustain Huber's position that the Commission exceeded its statutory authority in reinstating Pedernales' previous rates for 'LP' customers based upon its conclusion of law. APTRA § 19(e)(2)." *Id.* at 957.

230. *See id.* at 957. There is no doubt that in determining rates, the PUC may consider system-wide data. *See* City of Corpus Christi v. Public Util. Comm'n, 572 S.W.2d 290, 296 (Tex. 1978). It is important to note that the Texas Supreme Court did not authorize the PUC to establish system-wide rates. *See id.* at 296.

231. Public Util. Comm'n v. J.M. Huber Corp., 650 S.W.2d 951, 957 (Tex. App.—Austin 1983, no writ). The court provided the following other examples of instances when the Commission might be authorized to change the municipal rate decisions:

> There may . . . be cases where the Commission could fix an intra-city rate derived from system-wide date furnished by the utility, on the theory that the governing body of the municipality should have made no allocation at all of the system-wide data. Moreover,

The clear implication of the *Huber* decision is that the traditional notion of the de novo review is no longer acceptable.[232] While the Commission retains the power to change a rate fixed by a municipality, it cannot do that in an arbitrary and capricious fashion. In other words, the Commission must discontinue its historical practice of "simply set[ting] aside [a] rate . . . fixed in . . . [municipal] ordinance . . . upon the general principle that such [a rate is] not in the public interest."[233]

The reasoning in *Huber* is very much applicable to the Commission's treatment of the decertification issue with respect to Allens Creek. It reached a "naked and unqualified" conclusion of law that Allens Creek did not require decertification; that the local regulatory decision-makers had the authority to treat the project as cancelled, and that pre-completion project termination expenses were allowable. As was the case in *Huber,* these Commission generalizations were "so broad and unconnected to the underlying findings of fact as to preclude meaningful judicial review. . . ."[234] The full impact of *Huber* on Docket Number 4540 remains to be seen. When, and if, the Texas Supreme Court reviews *Huber,* the role and scope of the local regulatory authorities may be more precisely adjusted

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the commission may also fix an intra-city rate within the 115 percent differential allowed by PURA § 44, on a theory that the circumstances did not warrant the Commission's approval of a greater differential. Finally, the Commission may fix an intra-city rate based upon a proper application of some other substantive or precedural requirement of PURA where the rate set by the municipality's governing body resulted from its erroneous interpretation or application of such a provision.

Id. at 957.

232. *See id.* at 957; *see also* Lone Star Gas Co. v. State, 153 S.W.2d 681, 692 (Tex. 1941). A *de novo* trial means new or fresh; a court which tries a case *de novo* is vested with power to adjudicate all issues and rights of the parties and treat the case as if it had been originally filed in that court. *Id.* at 692.

233. Public Util. Comm'n v. J.M. Huber Corp., 650 S.W.2d 951, 957 (Tex. App. Austin-1983, no writ). The court noted that the Commission's decision was founded on its "naked and unqualified legal conclusion" that reducing the rates of one class of rate payers without reducing the amount charged others who are affected by the reduction violates public interest. *Id.* at 957.

234. *Id.* at 957-58. The court held as follows:

"If the Commission had concluded that it was not in the public interest for the city to fix rates for one class, in this particular case, and made findings of fact which support that conclusion, we would be faced with a different case. The Commission has not done so . . . but . . . simply declared Marble Falls' rate ordinance invalid because selective rate reductions are in their very nature against the public interest."

Id. at 958.

and defined. In the interim, it may be concluded that the rigidity of the *de novo* appellate review practice is softening.

In addition to the administrative and regulatory issues already discussed, there is one other point which must be made, and which has a far reaching implication. If the Commission's legitimation of HL&P's unilateral decision to terminate Allens Creek is allowed to stand, it will open the door for other similar unilateral decisions. All over the United States nuclear generation facilities are running into difficulty of one sort or another.[235] Moreover, the costs associated with their construction is escalating to unbelievable heights.[236] Cancellations and abandonments are almost becoming the norm rather than the exception. Given these observations, together with the particular reality of the financially strained South Texas Nuclear Project, discretionary acceptance of the right of a utility to decide unilaterally to cease construction, to abandon or cancel a facility and to pass those costs through to its rate payers is a dangerous notion. Allens Creek differs from South Texas only in the degree of completion. Neither can "be described as in use, or furnishing anything to HL&P's service area[s] under the present state of facts."[237] Therefore, at any point or for any reason, using the logic, theory, and experience of Allens Creek, HL&P could cancel the South Texas Project and pass the cost of cancellation on; if HL&P has that *right,* so does every other Texas utility doing business in the nuclear field.

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235. *See* Grienes, *A $1.6 Billion Nuclear Fiasco,* 122 TIME, Oct. 31, 1982, at 96, 99.

236. *See id.*

237. Docket No. 4540, Application of Houston Lighting and Power Company for a Rate Increase, Examiner's Report 46 (Dec. 6, 1982).