Report of The Committee On Regulations — Parts II And III Of The Federal Power Act

I. Introduction

Electric wholesale rate regulation in 1981 was at once routine and portentous. The routine aspect was the stream of Commission opinions on cost of service issues that a few years ago would probably have been considered peripheral. The portent of things to come was the Commission's rulemaking calendar, jammed with significant issues under investigation, and the tax order on tax normalization rendered during the year. The Commission is continuing its prior initiatives to streamline its proceedings through rulemakings on components of the ratemaking and administrative process; the rules that have resulted, however, will generally affect only future events and were not reflected in opinions rendered during the reporting period.

II. Rulemaking Proceedings

During the 1981 reporting period only three subjects reached final rulemaking: further required PURPA rules, administrative improvements in the Commission's process, and tax normalization.

Plainly the rulemaking policy decision of the year was on tax normalization. Orders No. 144 and No. 144-A (Docket No. RM80-42) have capped years of debate at the Commission (and litigation at the Court of Appeals) by not merely permitting but requiring for ratemaking purposes that electric utilities (and natural gas pipelines) under the Commission's jurisdiction use tax normalization for "miscellaneous timing differences" to compute the income tax component of their ratemaking cost of service. The Order only applies on its face to wholesale rates but can be expected to be significant (if not persuasive) precedent in the states' retail electric ratemaking.

This order culminates some ten years of federal rulemaking on the subject. Order 530 (Docket No. R-474) announced in 1975 that the Commission's general policy would be to favor tax normalization; but the next year, in Order No. 530-A, the Commission substantially retreated in the face of a perceived court requirement that utilities must show that a "tax deferral" rather than a "tax savings" would result in order to qualify a class of items for normalized rate treatment. On reconsideration in 1976, in Order No. 530-B, the Commission found its prior "reasoning to have been incorrect" (that deferred taxes had to be shown eventually to reach the cross-over point and diminish for the class for which normalized treatment was proposed) and instead allowed tax normalization in any case where the difference between tax and book recognition of an item "is clearly only a timing difference". A group of municipal and cooperative systems promptly appealed; but Order No. 530-B remained in effect (with reliance upon it subject to refund) pending the clarification on remand directed by the court in *Public Systems et al.* v. *F.E.R.C.*, 606 F.2d 973 (D.C. Cir. 1979).

Order No. 144 is the Commission's order on remand. Much of it is devoted to a point-by-point response to the Court of Appeal's concerns. [Rehearing of

Order No. 144 was subsequently denied, the order was "clarified" in recognition of ERTA, and the matter went before the Court of Appeals again on the same day. Order No. 144-A (issued Feb. 22, 1982); *Public Systems et al.* v. *F.E.R.C.*, Case No. 82-1183, D.C. Cir. (filed Feb. 22, 1982), now consolidated with No. 82-1214 and No. 82-1358.]

On the administrative front, the Commission expanded the range of routine decisions under Part II of the Federal Power Act delegated to the Director of the Office of Electric Power Regulation and others of its Staff. Order No. 147 (Docket No. RM81-20) completes "Phase III" of the process begun in its unnumbered order of August 14, 1978 (Phase I) and in Orders No. 38 and 38-B of 1979-80 (Phase II). By Order No. 146 (Docket No. RM81-3) federal entities which are "utilities" subject to the Commission's jurisdiction were relieved of the Form 1 reporting requirement; this presaged the major revisions to Form 1 for all other electric utilities being contemplated in Docket No. RM80-55 at the end of the year [*see* Order No. 200, Jan. 6, 1982]. In Order No. 140 (Docket No. RE81-26) a new format for reporting interlocking directorates was announced.

One of PURPA's less known requirements is that of §206, which requires utilities serving wholesale customers to submit "contingency plans" in the event of a shortage of power and to report any shortages in the next year which are anticipated. The Commission extended its "interim regulations" (See Docket No. RM79-55) again in 1981 for another year (order issued April 23, 1981).

Finally, the Commission tinkered further with the rules governing "qualifying facility" eligibility as a cogenerator or small power producer for purposes of PURPA §210. In 1980, Order No. 70 established the basic "50%" rule to implement PURPA §201 (qualifying facilities must be owned less than 50% by entities primarily engaged in the generation or sale of electric power, other than solely from qualifying facilities). The ownership criterion was clarified in Orders No. 70-B and 70-C, and further clarified during 1981 in Order 70-D (Docket No. RM79-54). Also, in Order No. 70-E upon completion of the Commission's Final Environment Impact Statement regarding diesel and dual-fuel cogeneration, the Commission withdrew its interim exclusion of such units from qualifying status. In Order No. 135 (Docket No. RM81-2) the Commission extended qualifying status to geothermal facilities and, pursuant to certain amendments to PURPA §210 contained in the Energy Security Act of 1980 (the "Windfall Profits" legislation) the Commission by rule exempted even utility-owned geothermal small power production facilities from the Public Utility Holding Company Act. The Commission said it "does not yet reach the issue of extending the 'avoided cost' rate principals to such facilities" [*but see* Docket No. RM82-11].

At the end of 1981, the Commission's rulemaking calendar included the following dockets pending under Parts II and III of the Act:

RM82-7 qualifying facilities
RM82-4 Form 423 revisions
RM81-40 FOIA Request fees
RM81-38 CWIP in rate base
RM81-4 preservation of records

RM80-60 revision of *ex parte* rules
RM80-36 generic return on equity
RM79-80 price squeeze substantive rules
RM79-79 price squeeze procedural rules
RM79-52 reporting capacity shortages (interim rule issued)
RM79-49 cash working capital
RM79-28 §202(c) emergency rates
RM78-22 revision of rules of procedure
RM77-1 return on equity [subsumed by RM80-36 but never terminated]

Thus, major factors in the ratemaking process were (and remain) before the Commission for rulemaking action: cash working capital, construction work in process, return on equity, and price squeeze. Comments have been received in those proceedings. If the Commission's members have a mind to institute reforms rapidly in existing dockets, they have these opportunities. If, on the other hand, they wish to wade into such regulatory thickets as electric utility curtailment plans, transmission pricing in emergencies, or more public reporting of fuel procurement, they have those opportunities also.

III. Commission Opinions

A. *Jurisdiction*

In an order issued May 26, 1981 in Docket No. ER81-183, the Commission asserted jurisdiction over distribution services offered by Consolidated Edison to ultimate consumers. The transactions were from the Power Authority of the State of New York (PASNY) at the generation level to certain State agencies located elsewhere on Con Ed's system *see New York State Electric & Gas Corp.* v. *F.E.R.C.*, 638 F.2d 388 (2d Cir. 1980). Con Ed filed a "transmission" rate for the through service with the Commission, but then sided with PASNY in opposition to FERC jurisdiction over the "distribution" part of the transaction. The Commission, however, asserted jurisdiction over the complete transaction, as a "single transaction which constitutes the transmission of electric energy in interstate commerce", although it also deferred to the retail rates fixed by the New York Public Service Commission as an "arbiter" under the contract. In order to circumvent the "local distribution facilities" exclusion from its jurisdiction in §201(b) of the FPA (which parallels the "generation facilities" exclusion in the same subsection), the Commission held that that provision of the Act only "establishes a legal standard for distinguishing between companies which are 'public utilities' as defined by the Act and those which are not. It neither applies to nor deprives the Commission of jurisdiction over sales for resale or transmission in interstate commerce."

B. *Cost Of Service*

1. Rate Base

Accumulated Deferred Taxes — Middle South Utilities Inc. was ordered to remove accumulated deferred taxes from rate base in *Middle South Services, Inc.*, Opinion 124. The Commission agreed with the Administrative Law Judge's decision that the utility had waived its right to present argument on this issue and also said that Section 2.12 of the Commission's regulations required deduction from rate base of balances in Account 282, "Accumulated deferred income taxes — Other property".

Construction Work in Progress — The Commission in Opinion 133 rejected *Public Service Company of New Mexico's* request to permit construction work in progress (CWIP) for construction of new coal-fired generating capacity, saying that it had made a deliberate decision in Order 555 to treat construction of new coal generating facilities differently from conversion of plants from gas or oil to coal. Order 555 permits CWIP for plant conversion.

Construction Work in Progress — Emergency and safety systems of a nuclear plant do not qualify for pollution control construction work in progress treatment under Order 555, the Commission ruled in *Louisiana Power & Light Company,* Opinion 110, upholding the initial decision's determination that only the "radwaste system" qualifies for pollution control CWIP. The Commission also ruled that the 13-month-average plant balances of pollution control facilities should be the measure of CWIP instead of the end of year plant balance.

Plant Cancellation Costs — A utility should be allowed to recover its AFUDC related to the investment of common equity shareholders in a cancelled nuclear plant and should not be required to reduce its rate base by the unamortized balances in its deferred tax account (Account 283) related to the plant cancellation, the Commission declared in overruling the initial decision on these two issues in *Northern States Power Company,* Opinion 134. The fact that Northern States had no contractual obligation to compensate the equity (as opposed to debt) investors was not a reason to deny equitable recognition in allocating abandoned project costs between ratepayers and shareholders (see Opinion No. 49). The Commission affirmed the initial decision's use of estimates in computing the amount of the write-off in connection with the cancellation of the Tyrone Nuclear Plant so long as such estimates were reasonable and especially where the estimates would be adjusted during the course of the amortization period to conform to the actual expenditures.

Plant Repair — The Commission upheld an Administrative Law Judge in denying inclusion in rate base of AFUDC of $4.3 million and repair cost of $2 million for the five months that a major fossil plant was out of service and undergoing repairs because of a boiler implosion in *Virginia Electric and Power Company,* Opinion 118. The Commission, however, allowed the utility to amortize over a five-year period the remaining repair cost, net of insurance, denying the Staff's request that the shareholders bear the entire cost. The record did not support the Staff's claim of management imprudence, the Commission said.

Depreciation — The utility's estimated service lives of 27 years for four major fossil generating units were accepted by the Commission in *Virginia Electric and Power Company,* Opinion 118, despite a contention of municipal intervenors that the utility should be bound by its Power Supply Department's estimates on two separate occasions that the plants had service lives of 35 years. The Power Supply Department's estimates were little more than estimated retirement dates from an engineering standpoint, said the Commission: "The estimated service lives used to fix the proper depreciation to be reflected in rates must be a management decision which takes into account not only the physical condition of the particular facilities, but also the future generation mix, *i.e.* the manner in which the units are planned to be used in the future, the way in which they will be operated, and their position in the overall load scheduling curve."

Cash Working Capital — The Commission rejected inclusion of estimated future nuclear fuel disposal and storage cost in O&M expenses for application of the 45-day cash working capital formula (as modified by *Carolina Power & Light Company* Opinion 19-A), in *Virginia Electric and Power Company,* Opinion 118. It stated that spent nuclear fuel cost does not reflect an expense which the utility will pay currently and does not represent a need contemplated within cash working capital.

The Commission also found defects in a lead-lag study introduced by the intervenors and adopted by the Judge in his initial decision, in *Louisiana Power and Light Company,* Opinion 110. There, the Commission followed the *Carolina Power & Light Company* Opinion 19-A method, reducing to 14.55 days the working capital for fuel and to 17.51 days the amount for purchased power. The major defect in the lead-lag study was its use of the weighted average of the expense lags for fossil fuel, labor, and purchased power as the lag for all other operating and maintenance expenses. "No evidence was introduced to support this proposition," the Commission said, "and we know of no reason that supports it."

2. Expenses Other Than Fuel

Tax Rate Change — A reduction in deferred taxes resulting from a change in the Federal corporate income tax rate from 48% to 46% should be flowed back to the wholesale customers over the remaining life of the plant to which the deferred taxes relate rather than over a 5-year period as suggested by Municipal wholesale customers, the Commission ruled in *Virginia Electric and Power Company,* Opinion 118-A.

Industry Association Contribution — The Commission permitted EEI contributions in the cost of service in *Public Service Company of New Mexico,* Opinion 133, for those research and development projects to which independent contributions could not have been made by the utility's wholesale customers.

Rate Case Expense — The Commission affirmed the initial decision in denying the utility's proposal to omit recovery of any rate case expense in the proceeding upon the condition that it could recoup the expense in future rate proceedings. It adhered to its earlier precedents to the effect that the total rate case expenses reasonably incurred in a rate proceeding should be amortized over the period that the rates are likely to be in effect. *Public Service Company of New Mexico,* Opinion 133.

3. Fuel Expense

Test Period Synchronization — Fuel revenues should be synchronized with fuel expenses, the Commission ruled in *Utah Power & Light Company,* Opinion 113. However, the Commission adopted an adjustment based on monthly rather than annual costs. "The purpose of the adjustment should be to develop test year revenues which are synchronized with test year expenses and, because fuel adjustment clause revenues are computed on a monthly basis, the fuel synchronization adjustment should also use monthly data," the Commission said.

Purchased Coal Costs — The Commission affirmed the Judge's conclusion in the initial decision in *Public Service Company of New Mexico,* Opinion 133, that the reasonableness of the cost of coal purchased from an affiliate should be determined by comparison to the prices of coal available from non-affiliated supplies.

Spent Nuclear Fuel — In *Carolina Power & Light Company,* Opinion 132, the Commission ruled that the utility failed to provide adequate record evidence to justify either interim or permanent disposal costs of spent nuclear fuel. The utility might, however, in another case, present evidence which might justify the pass-through of interim disposal costs or permanent transportation and storage costs associated with spent nuclear fuel disposal, the Commission said.

Spent Nuclear Fuel — Estimates of the future costs of interim transportation of spent nuclear fuel away from the reactor site and interim storage of spent nuclear fuel were permitted to be charged as part of the cost of service in *Virginia Electric and Power Company,* Opinion 118. The Commission denied the utility's request for estimated costs of permanent storage of spent nuclear fuel, however, "due to the uncertainty that exists concerning the federal reprocessing policy." The Commission also upheld the Administrative Law Judge's decision that Vepco would be permitted to discontinue carrying the spent fuel on its books as an asset and that it need not consider spent fuel as having salvage value when it computes its depreciation charges.

Fuel Adjustment Clause — The Commission in *Carolina Power & Light Company,* Opinion 132, ruled that it was inappropriate to charge through a fuel adjustment clause estimates of permanent storage and disposal costs of spent nuclear fuel. "Such costs are particularly inappropriate for automatic fuel clause recovery because they not only involve estimates of costs which have not been incurred, but they are also based on assumptions regarding an uncertain government policy on reprocessing. To permit a utility to change its rates based on such discretionary estimates and assumptions would deprive the Commission of its authority to ensure just and reasonable rates."

Fuel Adjustment Clause — The Commission issued a Declaratory Order in *Electric Cooperatives of Kansas,* Docket No. EL81-2, ruling that it was improper to pass through a fuel adjustment clause the cost of limestone used in pollution control scrubbers.

4. Cost Of Service Adjustment Clause

In *Middle South Services, Inc.,* Opinion 124, the Commission accepted proposed cost of service formulae as a rate, without any attached review conditions, "because the proposed formulae provide for upward and downward adjustments in essentially all of MSS' costs, and because the sales involved are among affiliates operating on a pool basis." The Commission provided that the costs which are distributed to the operating companies under the formulae would be subject to audit or §206 investigation by the Commission.

C. *Cost Allocation*

1. Allocation Of Transmission Services

A claim that costs of wheeling government preference customer power from Southeastern Power Administration (SEPA) projects to cooperatives were being unwillingly borne by municipal wholesale customers was denied by the Commission in *Virginia Electric and Power Company,* Opinion 118-A. The Commission said that the arrangement between Vepco and SEPA was not a true wheeling arrangement and that Vepco was, in effect, paid for the wheeling through the load diversity it garnered from the arrangement and also through other benefits it received by being able to dispatch the SEPA generation against its system-wide load.

2. Allocation Of Demand Costs

The Commission adopted the utility's 4-CP demand cost allocation method in *Louisiana Power & Light Company,* Opinion 110, where such method had been adopted in an earlier case involving the same utility and where there was not sufficient evidence of changed circumstances to warrant using another cost allocation method.

The Commission affirmed the initial decision's use of the average of the 12 monthly concident peak demands to allocate demand related costs in *El Paso Electric Company,* Opinion 109. The utility's lowest monthly peak was 71% of the maximum system peak and the average of 12 monthly systems peaks was 84% of the maximum peak. There being relatively high monthly peaks throughout the year, the use of the 12-month average CPs was proper, the Commission said.

3. Rolled-In Transmission Costs

In *Utah Power & Light Company,* Opinion 113, the Commission affirmed the judge's decision that all transmission costs, including those labeled "subtransmission", should be allocated on a rolled-in basis. Although 55% of the subtransmission lines served primarily distribution functions, they also served as backup and support for the integrated transmission system. They generally parallel the high voltage transmission facilities and perform functions similar to the high voltage transmission system and the rolled-in approach is justified, the Commission said.

4. Incremental Cost Allocation

The Electrical Service Agreement, under which Louisiana Power and Light (LP&L) Company had served the City of Winnfield, Louisiana since 1961, expired on May 14, 1981, and LP&L filed a proposed interconnection agreement with the Commission under which it offered to serve Winnfield at prices based on incremental instead of average fuel cost allocation. Winfield filed a complaint with the Commission on April 10, 1981, and LP&L on May 12, 1981, filed a copy of the proposed interconnection agreement, which Winnfield had refused to sign, as its offer to continue service to Winnfield. After expedited hearings, Administrative Law Judge Brenda Murray ruled on November 2, 1981, that LP&L would have to continue serving Winnfield under rates based on average rather than incremental fuel costs. The Commission affirmed Judge Murray's decision on December 11, 1981, in *Louisiana Power & Light Company,* Docket Nos. ER81-457 and EL81-13, and it rejected LP&L's proposal to limit Winnfield's demand to 20,000 kVa as anticompetitive.

5. Transmission Capacity Costs

The Commission ruled that no transmission capacity costs should be allocated to an interruptible customer in *Kentucky Utilities,* Opinion 116. Under the contract between the utility and the City of Paris, the City had the right to buy surplus energy from the utility but the utility had a right to interrupt this service up to 400 hours during any 12 consecutive months or 1000 hours during any five consecutive years. Under the peak responsibility method of cost allocation, the City should not be allocated transmission capacity costs, the Commission said, because the utility did not have to serve it during peak periods.

6. Transmission Loss Factors

Where transmission loss factors differed between different rate schedules, the individual transmission loss factors should be used rather than a rolled-in approach, the Commission ruled in *El Paso Electric Company,* Opinion 109.

D. Capital Structure And Return

1. Capital Structure

The Commission rejected the utility's hypothetical "target" capital structure in *Middle South Services, Inc.,* Opinion 124, in favor of the latest available evidence of capital structure and said as the parent company's actual capitalization ratios change, they should be reflected in the cost of service formulae.

In *Virginia Electric and Power Company,* Opinion 118, the Commission ruled that the $27.8 million reduction in par value of new preferred capital stock carrying a higher dividend rate, which was exchanged with shareholders for older preferred stock having a higher par value but lower dividend rate, should be included in the utility's capital structure at a zero return rather than at a 4.71% cost rate as sought by the utility (representing the difference between the cost incurred in raising the "new" capital and the cost of issuing a like amount of common stock).

2. Return On Equity

A return on equity of 14.4% was authorized to the utility in *Public Service Company of New Mexico,* Opinion 133, due "to the extremely volatile money market conditions in the last year, the rising cost of capital, and the impact of these factors on the capital intensive electric utility industry" and in light of PSNM's major construction program. The initial decision had determined that a range of 12.6-14.4% was reasonable but had awarded 13.25%.

The Commission, in *Middle South Services, Inc.*, Opinion 124, determined that the rate of return on common equity in a formula-type rate in an affiliated-companies pool should be the cost of equity of the operating companies' parent, Middle South Utilities, Inc. The Commission adopted the Staff's proposed 14% return on equity, agreeing with the Administrative Law Judge that traditional rate of return analyses in the record were flawed while the Staff's Discounted Cash Flow analysis was "thoughtful" and "well-supported".

A return on equity of 14% was granted in *Louisiana Power & Light Company,* Opinion 110. The Commission said it was proper in determining the return on equity to consider increased financial risks caused by the exclusion from rate base of large amounts of CWIP generated by a large construction program.

E. *Rate Design*

1. Demand Ratchet

A 70% demand ratchet based upon peak usage during the months of June, July, August and September was approved by the Commission in *Louisiana Power & Light Company,* Opinion 110.

The Commission affirmed the elimination of a demand ratchet in *Minnesota Power & Light Company,* Opinion 112. It also affirmed the trial judge's decision to require the utility to file revised rates to be effective prospectively only, and to make refunds to those customers who made overpayments to the extent that the utility was not subjected to undercollections and thus was still able to recover that which was ultimately determined to be its proper cost of service. The Commission stated,

> "In the past we have found that under certain circumstances it is not appropriate to subject a company to liability for undercollections. We make the same finding here. MP&L was following its historical practice of including demand ratchets when it made its filing and was acting consistently with Commission policy concerning MP&L at that time. We therefore agree with the judge that equitable considerations do not justify requiring MP&L to absorb the loss associated with full refunds."

The Commission rejected a 70% demand ratchet as not cost-justified in *Utah Power and Light Company,* Opinion 113. The Commission also found the ratchet to be discriminatory on its face since it was not applied uniformly among the customers in the class.

F. *Services*

There were no services opinions during this reporting period.

G. *Contracts And Discrimination*

1. Contracted Rates

Customers' failure to object to previous rate filings did not constitute a "mutual course of dealing" or a waiver which would modify rate contracts that did not permit unilateral rate increase filings by a utility pursuant to Section 205 of the Federal Power Act, the Commission ruled in *Utah Power & Light Company,* Opinion 113.

H. Unfair Competition

1. Price Squeeze

In *Public Service Company of New Mexico,* Opinion 133, the Commission ruled that the resolution of a price squeeze issue should be deferred until after approval of a compliance filing implementing the otherwise just and reasonable wholesale rates. Otherwise there is no just-and-reasonable-but-for-price-squeeze wholesale rate to compare to the retail rate *then* in effect.

Fuel charges made through automatic adjustment clauses at the retail and wholesale level must be taken into consideration in determining a *prima facie* price squeeze, the Commission decided in *Southern California Edison Company,* Opinion 128. The municipal wholesale customers had argued that fuel charges need not be taken into consideration since both the retail and the wholesale clauses, while based on different time periods, recovered penny-for-penny actual fuel costs and thus would have no impact on a rate of return comparison of retail and wholesale rates. The Commission ruled that fuel charges were a part of the rates that must be compared in price squeeze analysis and that it was not material that the clauses were based on different time periods.

2. Restrictive Resale Provisions

Rate schedule provisions limiting purchasers' use of electricity to resale to ultimate customers were determined to be unlawful in *Louisiana Power & Light Company,* Opinion 110, on the basis of the Supreme Court's ruling in *Gulf States Utilities Co.* vs. *FPC,* 411 US 747 (1973). The Commission said the restrictions conflict with the objectives of the antitrust laws since the restrictions prohibit the further wholesaling of power purchased under the rate schedules and thus foreclose competition between the utility and its wholesale customers.

IV. Appellate Review

A. Arkansas Louisiana Gas Company *v.* Hall, *453 U.S. 571, 69 L.Ed 2d 856 (1981).*

This case, strictly limiting if not undermining the *Mobile-Sierra* doctrine, arose under the Natural Gas Act rather than the FPA; but the Court noted (69 L.Ed at 863 n. 7) that in this case it followed its established practice of "citing interchangeably" decisions under the two "substantially identical" statutes.

The case involved a filed, fixed-price contract which contained a "favored nation" clause permitting Hall (the natural gas producer) to raise his price to Arkla (the pipeline customer) to the higher level paid by Arkla to any other producer in the same gas field. A few years later Arkla began paying a higher price (to someone that Arkla in good faith did not consider to be a "producer") and Arkla did not tell Hall. Hall eventually found out and sued Arkla in Louisiana for breach of contract and civil damages.

The Louisiana court found that Arkla had breached the contract, and attempted to fix damages equal to the additional amount Arkla would have paid Hall had the price been raised under the contract. FERC was consulted as to the measure of these damages. But the Commission opined instead that an award of damages based on what the rate might have been had a permissive act and a discretionary regulatory response taken place was in violation of the "filed rate doctrine". The Supreme Court agreed, calling this "nothing less than the award of a retroactive rate increase based on speculation about what the Commission might have done had it been confronted with the facts in this case. . . . It would undermine the congressional scheme of uniform rate regulation to allow a state court to award as damages a rate never filed with the Commission and thus never found to be reasonable within the meaning of the Act." Thus, "where there is a conflict between the filed rate and the contract rate, the filed rate controls." The Court "expressly disapproved" dictum in *City of Cleveland* v. *F.P.C.*, 525 F.2d 845, 854-55 (D.C. Cir. 1976) to the effect that a rate filed (and made effective) in violation of the contract between the parties would be invalid.

In a strong dissent, three Justices denounced the intrusion upon state contract law implied by the majority's decision and pointed out that the result in *United Gas Pipe Line Co.* v. *Mobile Gas Service Co.*, 350 U.S. 322 (1956), one of the "Mobile-Sierra" cases, would have been reversed under the majority's rule.

B. Mississippi *v.* F.E.R.C., ____ *F.Supp.* ____, *38 PUR4th 284 (S.D. Miss. 1981), probable jurisdiction noted,* ____ *US* ____, *69 L.Ed. 950 (No. 81-1749, 1981).*

The State of Mississippi obtained a declaratory judgment against the Commission and the Secretary of Energy, that PURPA Titles I and III and §210 are unconstitutional under the Commerce Clause and under the Tenth Amendment. The matter was taken up for decision by the Supreme Court and a decision was awaited at the end of 1981.

[The Supreme Court's decision upheld PURPA and reversed the District Court. ____ U.S. ____, 72 L.Ed 2nd 532 (June 1, 1982)].

C. Public Service Co. of New Mexico *v.* F.E.R.C., *653 F.2d, 681 (D.C. Cir. 1981).*

The Company, PSNM, appealed from the Commission's ratemaking handling of investment tax credits (ITC) under the former law, for a utility electing ratable flow through to cost of service (Option 2 treatment under Section 46(f)(2) as added to the Internal Revenue Code in 1971).

Specifically, the Commission did not reduce rate base for accumulated deferred ITC for ratemaking purposes and thus permitted the overall rate of return with respect to the deferred balance, but excluded the balance from consideration of the capitalization of the Company for rate of return purposes. PSNM argued that the balance should be included in capitalization at the higher rate of return on equity, on the "assumption," said the court, that if the ITC were not available, the capital thus supplied would have to come from the common shareholders. The court found the Commission's contrary assumption — that all sources of capital would contribute proportionately to make up the difference — to be neither arbitrary nor capricious.

PSNM further argued that by not including the accumulated deferred ITC in capitalization as common equity, the debt portion of its capital structure was overstated and thus the interest expense deduction for income tax purposes was overstated. The court rejected this "interest synchronization" argument on the same grounds.

D. Hatch *v.* F.E.R.C., *654 F.2d 825 (D.C. Cir. 1981)*

Mr. Hatch, a director of the Georgia Power Company, applied for permission under the interlocking directorate provisions of Section 305(b) of the F.P.A. simultaneously to hold a directorship in the parent corporation of a company authorized to underwrite public utility securities. In reliance upon past Commission precedent, he offered no evidence other than the nature of the proposed interlocking directorships and the absence of any indication that abuse of those relationships would result in harm to the public. The Commission, however, adopted its ALJ's recommendation that interlocking directorates should be considered invidious *per se,* absent an affirmative showing of public benefit from the interlocks. The Commission rejected Mr. Hatch's application for his failure to submit such an affirmative showing.

The court affirmed the Commission's new standard as a reasonable way to apply §305(b) prospectively, but remanded Mr. Hatch's application for an opportunity to provide the missing evidence, on the ground that he was entitled to rely on past Commission precedent in framing the evidence he presented absent notice of the Commission's changed substantive interpretation of §305(b). The court also directed the Commission to "explain why it is changing course" in order to inform the court and future applicants about the new nature of and grounds for the standard of proof under that section.

E. Villages of Chatham and Riverton, Ill. *v.* F.E.R.C., *662 F.2d 23 (D.C. Cir. 1981).*

Wholesale customers challenged certain Period II (test period) estimates by Central Illinois Light Co., their supplier. At the time of hearing the actual costs for the test period were available, but the Commission accepted the estimated figures as "based on the best information available at the time" and had not been shown to be unreasonable.

The court rejected this reasoning and held that the utility had to meet its burden of proof under §205(e) of the F.P.A. to support its estimates, by showing that the estimates were "reasonable when made" either by "explaining the chain of reasoning" or by comparison with actual data. The court, however, agreed that the Commission could nonetheless use estimates in lieu of known actual data, if reasonable when made, especially if the actual variance was based upon unusual or unique occurrences. The court affirmed certain estimates as reasonable (rejecting the challenge to isolated line items, including the Commission's refusal to change the FIT from 48% to 46%, by looking at the overall cost of service), but remanded others for clarification.

The court also rejected the Commission's position at oral argument that an argument not raised in the administrative proceedings below could not be raised for the first time in a petition for rehearing. The court noted that the evidence supporting the intervenor's argument in question was already in the record, and that FPA §313(b) merely requires that every objection before the court have been raised in the application for rehearing.

F. Illinois Cities of Bethany, et al. *v.* F.E.R.C., *670 F.2d 187 (D.C. Cir. 1981).*

This decision, as modified on rehearing, affirms and interprets the Commission's "price squeeze" rule (18 C.F.R. §2.17). The court at the outset upheld the Commission's view that demonstration of a *prima facie* case on price squeeze under the rule does *not* entitle the showing party to relief as a matter of law, but merely to further investigation of the allegations to see whether price discrimination exists. Moreover, the court affirmed the Commission's discretion to choose a methodology to test for *prima facie* price squeeze, including its choice not to use the "transfer price" test borrowed from antitrust litigation.

The court also affirmed the Commission's price-squeeze comparison of annualized current retail and wholesale rates, rather than just the rates in effect on the day the disputed wholesale rates became effective, in part based on a utility's inability to control timing and delays in the regulatory process. It concluded, "The *Conway* doctrine is not, . . . we emphasize, designed to subsidize particular retail competitors." However, the court indicated that the Commission could take price squeeze into account to adjust wholesale rates within the zone of reasonableness to respond either to retail rates depressed by the utility "to meet competition" *or* to "situations where the imperfections of regulation result in an unintended price squeeze."

The court also affirmed as "settled law" the non-reviewability of the FERC's decision not to institute a cost of service investigation requested by the Cities.

The original opinion of the court was to remand the matter for further investigation of price squeeze in view of the ALJ's erroneous analysis of the Cities' "transfer-price" test. That portion of the court's opinion was vacated on rehearing and the Commission's decision was affirmed.

G. New England Municipal Rate Committee *v.* F.E.R.C., *668 F.2d 1327 (D.C. Cir. 1981).*

This appeal, by both New England Power Company (Nepco) and a group of its municipal customers on different grounds, arose from three separate Commission proceedings concerning rate applications from 1973-1975. The lead issue (among eleven) decided by the court concerns the ratemaking treatment of Nepco's investment in cancelled generation construction which the Commission accepted as prudently commenced at the time; specifically, the Commission's decision to amortize the construction cost as an expense over five years but also to keep the unamortized portion out of Nepco's rate base.

Nepco argued that the Commission's approach denied the Company any opportunity to earn a return on investment prudently made in the public service, and thus constituted an unconstitutional taking of its property. The court, however, affirmed the FERC's view that the expenditure was for an item that never became property "used and useful" in providing electric service; hence, the Commission's valuation of the rate base was proper if the end result, the rate order, was just and reasonable, and the particular decision here was neither irrational nor inconsistent but "struck a reasonable balance between the interests of investors and ratepayers." The court also affirmed the Commission's exclusion of the Yankee investment from Nepco's capital structure, based on the Commission's explanation (on earlier remand) that Nepco was already compensated for that investment by its share of the Yankee companies' "profits". When it came to fixing a return on equity, the Commission first (consistently) fixed a composite 12.75% ROE for Nepco's parent company as an "appropriate proxy" for the equity components of Nepco's composite investment (the investment in Nepco's own operations plus the Nepco investment in the jointly-owned Yankee units). Then the Commission backed out the most recently-approved overall return on Nepco's share in the Yankee investment (10%) and arrived at a higher (13.28% ROE) return implied for the equity component of the investment in Nepco's own operations. The court rejected the intervening municipal's characterization of this action as allowing Nepco a higher-than-reasonable return on the Yankee investment (thus, allegedly violating the filed-rate doctrine by earning a higher rate than approved for the Yankee investment). Instead, it noted that the FERC's method carefully separated out the Yankee investment to prevent that result, and produced a just and reasonable "end result" for Nepco's own operations. At the same time the court affirmed the Commission's use of a different methodology in one of the earlier consolidated cases.

On the question of the rate of return permitted respecting the deferred balance of tax credits, the court affirmed its earlier opinion (in *Public Service Company of New Mexico* v. *F.E.R.C., supra*) that the overall return, rather than return on equity as argued by Nepco, was appropriate. Consequently, the FERC's assumption that, absent the ITC, Nepco's FIT interest deductions would increase (due to an increase in all categories of capitalization and not just in equity), resulting in less tax expenses in the test year, was consistent and reasonable. *Id.*

A number of the Commission's test period adjustments (and failures to adjust) were challenged but affirmed. Notably, the Commission's departure from the usual 45-day working capital rule was held reasonable under the circumstances. Also, with regard to the allocation of tax expense to retail and wholesale customers, the Court upheld the Commission's treatment despite the fact that the Rhode Island Commission had refused to recognize certain tax expense that the FERC methodology allocated to retail service. Two other minor issues, and the continuing question of tax normalization, were remanded for further proceedings by the Commission.

[The Supreme Court denied certiorari in Nepco's appeal from the decision of the District of Columbia Circuit. ____ U.S. ____, ____ L.Ed.2d ____ (June 14, 1982).]

H. Florida Power and Light Co. *v.* F.E.R.C., *660 F.2d 668 (5th Cir. 1981).*

This proceeding constituted the Commission's major policy setback of 1981 in the courts. As the court put it, "The crux of this controversy turns upon what authority the Commission has under the FPA to order the transmission of electricity, and what authority it has to control the format of its filings."

The facts concerned FP&L's transmission services offered to its municipal and cooperative customer's. Several similar rate schedules for such service to individual customers were consolidated in the proceeding, but FP&L did not file a generally-applicable tariff. In another proceeding, FP&L had rebutted allegations that it had unduly discriminated among potential users of its transmission services by presenting FP&L's current policy (consisting of four nondiscriminatory criteria) for the availability of its transmission services. The Commission ordered FP&L: (1) to file a generally applicable tariff in lieu of the separate rate schedules and (2) to include the four nondiscriminatory criteria in that tariff. The Commission (said the court) reasoned that FP&L's policy on availability was a "practice" it could require be filed pursuant to FPA §205(c). Furthermore, the Commission said that it (as a practical matter) the rate schedules tendered constituted such a similar set that FP&L would henceforth have to show that denying a similar rate to others was not unduly discriminatory. Therefore, the Commission concluded that the FP&L policy was in fact generally applicable and ought to be set out in a generally applicable tariff (for these reasons as well as for administrative efficiency). FP&L, however, argued that the requirement to file its current transmission policy in a tariff, available until withdrawn and available to customers not yet even named, constituted a Commission requirement that FP&L, in effect, act as a common carrier.

The court argeed with FP&L. It reasoned that filing such a tariff would make it subject to Commission investigation and alteration, and would make changes sought by FP&L subject to Commission approval; thus, FP&L's current "policy" to offer transmission services could be altered or perpetuated by the Commission over FP&L's objections, taking away the company's "freedom to alter its policy of availability with respect to wheeling." The court agreed with the Commission that the individual transmission rates filed by FP&L could not be discriminatorily different, but rejected the Commission's argument that a customer denied the service entirely (and thus not covered by a transmission rate schedule) would be discriminated against by FP&L's refusal to make the service available. That, said the court, would be an exercise of "precisely the authority which the FPA denies the Commission," citing *Otter Tail* and distinguishing *Town of Norwood.* On this basis, the court then refused to "vitiate Congress' desire" by permitting the Commission to require FP&L's wheeling policy to be filed as a "practice" under FPA §205(c), despite the deference normally owed to an agency construing its own statute.

The Court also refused to permit the Commission to order FP&L's wheeling policy to be filed as a remedy for "FP&L's history of anticompetitive conduct," on the ground that the Commission had made no such finding as to FP&L

in this proceeding. Findings that FP&L had monopoly power and that the proposed filing would be "procompetitive" did not authorize such a remedy (and the Court reserved judgment as to whether even a specific finding of anticompetitive activity or antitrust violation would be sufficient).

I. City of Anaheim et al. *v.* F.E.R.C., *669 F.2d 799 (D.C. Cir. 1981).*

California Edison Company's rate case for test year 1976 was decided (in Opinions 62 and 62A) to the dissatisfaction of the appellant municipal customers on certain transmission allocations and on certain purchase power contract losses. The Company was itself dissatisfied with the 12.75% return on equity, exclusion of non-cash expenses from working capital, rejection of deferred fuel expense under a "fixed-rate" fuel adjustment clause, and treatment of certain abandonment costs. On appeal the court affirmed the Commission on all counts as not "unsupported by substantial evidence or adequate rationale."

In particular, the court addressed the Company's claim that (notwithstanding the "burden of proof" borne by the utility under FPA §205(e)) the utility was entitled to the presumption that its costs were prudently incurred. The court explained that that presumption as set out in earlier cases "does not survive a showing of inefficiency or improvidence" and endorsed the Commission's explanation (in Opinion No. 86) that "utilities seeking a rate increase are not required to demonstrate in their cases-in-chief that all expenses were prudent. . . . However, where some other participant in the proceeding creates a serious doubt as to the prudence of an expenditure, then the applicant has the burden of dispelling these doubts and proving the questioned expenditure to have been prudent."

J. Union Electric Co. *v.* F.E.R.C., *668 F.2d 389 (8th Cir. 1981).*

This appeal was taken from Union Electric's 1980 general rate case (Opinion No. 94) by the company and by a group of wholesale customers. The court affirmed the Commission's order in its entirety, as producing an end result within the zone of reasonableness.

Specific issues decided included taxes, rate of return, rate base items, and cancellation costs. With regard to rate of return, Union Electric objected that the 13% ROE authorized was based solely on a 6-month old review of U.E. subsidiary in another proceeding, but the court found substantial evidence of "similarity" with U.E. in this record.

The same question of the Commission's handling of ADITC (and of its effect upon interest expense) arose as in *Public Service Co. of New Mexico* v. *F.E.R.C., supra.* The Eighth Circuit panel, citing the D.C. Circuit's decision to reject PSNM's "interest synchronization" argument, did likewise. In addition to upholding the Commission's interpretation of the Internal Revenue Code, the court went on expressly to uphold the IRS regulations under 26 U.S.C. §46(f)(2) (the Code section at issue) on which the Commission had relied.

Intervenors contested several rate base items. The Commission's use of the conventional 45-day working capital allowance was upheld despite evidence of a lesser lag. Inclusion of routine materials and supplies in rate base prior to assignment to specific CWIP projects was upheld, as the best solution to "substantial logistical obstacles," over intervenor's argument that M&S intended for construction use should be estimated and excluded from rate base. The court also upheld a transitional adjustment to increase U.E.'s rate base to reflect deferred taxes in recognition that this was U.E.'s first rate increase to these customers since converting from flow-through to normalized taxes. The intervenors argued that settlement in the prior rate case disclaimed adoption of any method of tax accounting, but the court accepted as substantial evidence the testimony of a U.E. witness that "the settlement assumed flowthrough." Finally, the court upheld inclusion of cancelled generating unit expenditures in the cost of service, saying that "because [intervenors] did not present any evidence that the project was imprudent, the FERC did not have to make a specific showing of the project's prudence."

The court also upheld the FERC's approval of terms of service that the intervenors labelled "anticompetitive" including, among other things, that these customers could not accept power from another source (under normal circumstances) for the term of the contract (five years). The FERC had rejected another term of service requested by U.E., providing for a contract demand with service above that level at U.E.'s option.

K. *Later Decisions*

The following appeals were decided between January 1 and June 30, 1982 affecting Part II rules or opinions issued before 1982; these decisions will be reviewed in the Report for calendar year 1982:

1. *New England Power Co.* v. *New Hampshire,* ____ U.S. ____, 71 LEd.2d 188 (1982).
2. *American Electric Power Service Corp.* v. *F.E.R.C.,* 675 F.2d 1226 (D.C. Cir. 1982).
3. *Ohio Power Co.* v. *F.E.R.C.,* 668 F.2d 880 (6th Cir. 1982).
4. *Cities of Batavia, et al.* v. *F.E.R.C.,* 672 F.2d 64 (D.C. Cir. 1982).
5. *Delmarva Power and Light Co.* v. *F.E.R.C.,* 671 F.2d 587 (D.C. Cir. 1982).
6. *El Paso Electric Co.* v. *F.E.R.C.,* 667 F.2d 462 (5th Cir. 1982).
7. *Cities of Aitkin, et al.* v. *F.E.R.C.,* ____ F.2d ____, CCH Utilities Law Reporter ¶12554 (D.C. Cir. 1982).
8. *Cities of Kirkwood, et al.* v. *Union Electric Co.*, 671 F.2d 1173 (8th Cir. 1982).
9. *City of Frankfort* v. *F.E.R.C.,* 678 F.2d 699, 23 FPS 6-90 (7th Cir. 1982).

The Office of the Solicitor advises that additional appeals are pending in the following matters from 1981 or earlier:

1. Opinions 110 and 110A, Louisiana Power and Light Co.
2. Opinion 19A, Carolina Power and Light Co.

3. Opinion 132, Carolina Power and Light Co.
4. Opinion 116, Kentucky Utilities.

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