

BEFORE THE MINNESOTA PUBLIC UTILITIES COMMISSION

Barbara Beerhalter	Chair
Cynthia A. Kitlinski	Commissioner
Norma McKanna	Commissioner
Robert J. O'Keefe	Commissioner
Darrel L. Peterson	Commissioner

In the Matter of the
Application of Interstate Power
Company for Authority to
Increase its Rates for Electric
Service in Minnesota

ISSUE DATE: July 5, 1988
DOCKET NO. E-001/GR-86-384
ORDER AFTER REMAND

PROCEDURAL HISTORY

On May 1, 1987, following contested case proceedings, the Commission issued its Order setting final rates in the above-captioned general rate case. That Order allowed Interstate Power Company (Interstate or the Company) an annual rate increase of \$373,817. The Commission denied petitions for reconsideration and rehearing, and the Company filed an appeal with the Minnesota Court of Appeals, seeking an additional increase of \$737,976.

On December 15, 1987 the Court of Appeals issued its decision, affirming in part, reversing in part, and remanding certain issues to the Commission for further consideration.

The remanded issues came before the Commission on May 26, 1988. Clement F. Springer, Jr. and William D. Carstedt, Defrees and Fiske, Chicago, Illinois, appeared on behalf of the Company. Gary R. Cunningham, Special Assistant Attorney General, appeared on behalf of the Office of the Attorney General. Mary Jo Murray, Special Assistant Attorney General, appeared on behalf of the Department of Public Service.

STATEMENT OF THE ISSUES

The following issues were remanded to the Commission: (1) the Company's claim that its Keokuk coal stockpile constituted working capital; (2) the rationale for allowing recovery of some of the costs associated with the cancelled Carroll County nuclear plant while disallowing others; (3) the disallowance of interest incurred

in connection with cancelled projects.

FINDINGS AND CONCLUSIONS

Having heard the arguments of counsel, and having examined the records and proceedings herein, the Commission makes the following findings and conclusions.

Keokuk Coal Inventory

Coal inventory stored at Keokuk, Iowa is used to supply the Lansing #4 generating plant. This coal is shipped from Wyoming to Keokuk via a single unit train and then shipped via barge 300 miles to the Lansing site. The Commission allowed a 90 day at-plant supply of fuel inventory but disallowed the coal supply located at Keokuk on grounds that a 90-day coal supply was all that was necessary, prudent, and therefore chargeable to Minnesota ratepayers.

It is somewhat unclear whether this issue has been remanded to the Commission. The syllabus and the factual summary of the decision state that the Commission failed to address the Company's argument that the Keokuk coal stockpile constituted working capital. The syllabus states that that issue would be remanded to the Commission. The body of the opinion, however, appears to dispose of the Company's working capital argument as follows:

The Commission's order does not address Interstate's claim that the coal at the Keokuk site constitutes working capital. However, whether the coal is considered inventory or working capital, it is still coal; the important question is whether it may receive rate base treatment. The Commission accepted the ALJ's determination that a 90-day average fuel inventory should be allowed in Interstate's rate base, and this determination has not been appealed. To find that additional coal may be allowed rate base treatment under a different theory would circumvent the Commission's determination that a 90-day fuel supply is reasonable.

In the Matter of the Petition of INTERSTATE POWER COMPANY for Authority to Increase its Rates for Electric Service in Minnesota, 416 N.W.2d 800, 810 (Minn.App.1988).

The Commission concludes that the court found the Order's failure to explicitly reject the working capital argument problematic. To eliminate uncertainty the Commission will again address the issue.

The Commission finds that the Keokuk coal stockpile cannot be treated as working capital for the reasons set forth by the court. Whether treated as inventory or as working capital, the coal must be reasonably necessary to the provision of utility service and prudently acquired to qualify for rate base treatment. The Commission has found that coal supplies in excess of a 90 day system-wide average inventory are imprudent and unnecessary. They therefore cannot be included in rate base as working capital.

Carroll County Project Costs

In its final Order, the Commission allowed Interstate to include in rate base the engineering costs incurred in the planning of a nuclear plant which was to have been constructed in cooperation with other utilities in Carroll County, Illinois. The Company entered the project in 1973 and withdrew in 1982. The Commission found that prudence had required the Company to withdraw earlier and to postpone some of the claimed expenditures until more progress had been made on determining the advisability of the project. Consequently, the Commission disallowed recovery of interest, legal fees, land acquisition costs, and administrative expenses associated with the project. The Court of Appeals remanded for an explanation of why engineering costs were allowed when other costs incurred in the same or earlier time frames were not.

The Commission allowed engineering costs while disallowing others because engineering costs differ in nature and purpose from the other costs and were necessary and appropriate.

Although the Carroll County nuclear plant ultimately proved to be an inappropriate investment for Interstate, the Company had to conduct engineering analyses even to consider the project's feasibility. The Commission has historically allowed such preliminary expenses and saw no reason to depart from that precedent here. Also, allowing such expenses, often termed Preliminary Survey and Investigation charges (PS&I), is consistent with regulatory practice generally. The Uniform System of Accounts, for example, provides for the recording of PS&I charges whether or not the project for which they were incurred is ever actually undertaken. The Uniform System of Accounts describes a PS&I account as follows:

This account shall be charged with all expenditures for preliminary surveys, plans, investigations, etc., made for the purpose of determining the feasibility of utility projects under contemplation.

18 CFR 101.183 A.

The Commission has always agreed that the Company's contemplation of the project, and even its initial participation in it, was reasonable and prudent. There was therefore no reason to disallow engineering costs, which were an unavoidable concomitant of any serious consideration of the project. The Company clearly met its burden of proof as to these expenses.

The other expenses -- legal fees, administrative expenses, land acquisition costs, and interest -- did not inevitably result from the originally prudent decisions to investigate and participate in the project. Although it is always difficult to determine which expenses of an abandoned project were reasonable and which should have been recognized as unjustifiable, the Commission remains convinced that the reasonable place to draw the line here is between engineering expenses and other expenses.

The Commission has found on the evidence that, once committed to the project, the Company failed to critically evaluate its continued participation in light of new developments and a changing environment. For example, the Company failed to take conservation into account in projecting its generation needs and continued to use an outdated forecasting method. Just as important, however, the Company also failed to critically evaluate the progress of the project itself and to perceive that, despite substantial Company expenditures, it was not proceeding beyond a purely preliminary stage. For this reason, the Commission found that only expenses appropriate to the preliminary stage of determining feasibility, engineering expenses, could be allowed.

As the Commission explained in its Order, the fact that the project remained in a preliminary stage should have been evident to the Company for at least two reasons. The first was that, even at the time of Interstate's withdrawal from the project, the participants still believed that applying for a Certificate of Convenience and Necessity from the governing jurisdiction, the State of Illinois, would be premature. The second was that, at the time of the Company's withdrawal, and even at the time of the closing of the record, no formal construction plans had yet been drawn up.

The Company therefore should have been on notice that the project was still in its infancy and that expenditures other than those normally made on nascent projects, e.g., engineering costs, might well not be recoverable from ratepayers. It is clear from the record that Company expenditures went significantly beyond that point. It is also clear that the Company should not have incurred these additional expenses, that the expenditures did not benefit ratepayers, and that they should not be recovered from ratepayers.

Furthermore, the Commission finds that the costs associated with land acquisition (purchase costs, property taxes, associated

interest) are especially inappropriate in that Interstate never acquired title to the land, could not sell it for the benefit of the Company or its ratepayers, and could not hold it for future use. Its project partner, Commonwealth Edison Company, held title to the land under a trust agreement executed by the project participants.

The Commission affirms its original determination that the Company, which has the burden of proof in this matter, has failed to show that expenditures other than engineering costs were reasonable, necessary, and justified by the stage of the project during which they were made.

Amortization of Interest on Cancelled Projects

In its final Order the Commission disallowed amortization of interest on the Company's two cancelled projects. The Court of Appeals remanded the issue for further explanation, noting that the Commission's characterization of these costs as quasi-AFUDC did not address the question of whether they should be borne by the ratepayers or the shareholders. The Court also noted that whether or not construction had begun was not by itself an adequate criterion for determining whether or not interest was recoverable.

First of all, it is important to state that the classification "AFUDC" (Allowance for Funds Used During Construction), which includes interest, carries with it considered policy judgments about how expenses which are so designated should be treated. Not only the Commission, but most utility regulatory bodies, including the Federal Energy Regulatory Commission, accept the general proposition that interest on projects not yet in service is not recoverable until they go into service.¹ At that time the interest becomes recoverable, subject to certain conditions.

Interest is not recoverable earlier because it represents a return on the company's investment and is therefore always in a separate category from other costs. Traditionally, utilities have not been allowed to earn a return of or on their investments until they become used and useful. The rule has been relaxed in Minnesota, and utilities may now add Construction Work in Progress (CWIP) to rate base, allowing a return on their investments under

¹ This is the accounting treatment mandated by the Uniform System of Accounts of the Federal Energy Regulatory Commission (called by its earlier title, the Federal Power Commission, in Commission rules). 18 CFR 101.3.A.(17). Commission rules require that utility accounting practices conform with the Uniform System of Accounts. Minn. Rules, part 7825.0300, subp. 2.

construction. This is seldom allowed, however, without imputing AFUDC income to the utility, diminishing its return on the CWIP component of the rate base. Minn. Stat. Section 216B.16, subd. 6a (1986). Earning a return on the capitalized imputed return represented by AFUDC must still await an asset's dedication to public service, its attaining used and useful status, and a Commission determination that recovery of interest on construction costs is in the public interest.

This distinction between returns on Construction Work in Progress and Allowance for Funds Used During Construction represents a preliminary policy judgment on how to balance shareholders' and ratepayers' interests, and has proven a workable approach. If a project never goes into service, however, the recoverability of interest is even more problematic and depends even more on the particular facts of the case.

On the particular facts of this case, the Commission has determined that interest is not recoverable. It is not recoverable as to the Carroll County project for the same reasons that legal, administrative, and land acquisition costs are not recoverable -- that project never left the nascent stage and these costs were prematurely and imprudently incurred.

It is not recoverable as to the White-Eldorado transmission project for a related reason. This project never progressed beyond the planning stage. The only costs incurred were planning costs. The Commission is convinced that AFUDC, which is the regulatory vehicle for the recovery of interest prior to plant operation, is not intended for such non-construction costs. Its very title, Allowance for Funds Used During Construction, supports this interpretation. Although common sense requires that "funds used during construction" be interpreted to include more than bricks and mortar, the Commission believes the costs in this case are too far removed from construction costs to qualify.

No aspect of regulation is more difficult than balancing the interests of ratepayers and shareholders in apportioning the costs of cancelled or abandoned projects. The Commission is convinced, however, that granting recovery of the prematurely incurred interest on the Carroll County project or the interest on planning (not construction) costs for the White-Eldorado project would be inequitable as to the ratepayers. For these reasons, the Commission reaffirms its earlier determination.

ORDER

1. Having received this matter on remand from the Court of Appeals, the Commission makes the above findings and conclusions.
2. This Order shall become effective immediately.

BY ORDER OF THE COMMISSION

Mary Ellen Hennen
Executive Secretary

(S E A L)