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COMMUNITY ENERGY SYSTEMS
AND THE LAW OF PUBLIC UTILITIES

Volume Forty-Six

UTAH

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Final Report of
A Study of the Impacts of Regulations
Affecting the Acceptance of
Integrated Community Energy Systems

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ABSTRACT

This report contains a detailed description of the laws and programs of the State of Utah governing the regulation of public energy utilities, the siting of energy generating and transmission facilities, the municipal franchising of public energy utilities, and the prescription of rates to be charged by utilities including attendant problems of cost allocations, rate base and operating expense determinations and rate of return allowances. These laws and programs are analyzed to identify impediments which they may present to the implementation of Integrated Community Energy Systems (ICES). This report is one of fifty-one separate volumes which describe such regulatory programs at the federal level and in each state as background to the report entitled "Community Energy Systems and the Law of Public Utilities -- Volume One: An Overview." This report also contains a summary of a strategy described in Volume One -- An Overview for overcoming these impediments by working within the existing regulatory framework and by making changes in the regulatory programs to enhance the likelihood of ICES implementation.

PREFACE

One response to current concerns about the adequacy of the nation's energy supplies, in addition to reducing consumption of energy, is to make more efficient use of existing energy resources. The United States Department of Energy (DOE) has funded research, development and demonstration programs to determine the feasibility of applying proven cogeneration technologies in centralized energy systems, known as Integrated Community Energy Systems (ICES), to provide heating, cooling and electrical services to entire communities in an energy conserving and economic manner.

The relevant "community" which will be appropriate for ICES development will typically consist of a combination of existing or potential energy "wasters" -- i.e., installations with large energy conversion facilities which, when operated in a conventional manner, exhaust usable amounts of waste heat or mechanical energy -- and existing and potential energy users -- i.e., industrial, commercial, institutional or residential structures which obtain electricity and gas from a traditional central utility and convert part of it on site to space heating and cooling purposes.

In most current applications, energy conversion facilities burn fuels such as coal, oil or natural gas to produce a

single energy stream such as process steam or electricity for various industrial processes or for sale to other parties. In the conversion process, substantial amounts of energy may be wasted. For example, it has been estimated that from 60 to 75 percent of the potential energy available in fuel burned to generate electricity is lost in the process of generating and delivering the electricity.

The technology exists, however, to produce and utilize more than one energy stream from most energy conversion processes so that the input of a given amount of fuel could lead to the production of far more usable energy than is generally true in most steam production processes. This technology is the foundation of the ICES concept. Current examples of the technology can be found on university campuses, industrial or hospital complexes and other developments where a central power plant provides not only electricity but also thermal energy to the relevant community.

It is generally assumed by DOE that ICES will be designed to produce sufficient thermal energy to meet all the demands of their communities and that they will be interconnected with existing electric utility grids. Through such an interconnection, an ICES would be able to purchase electricity when its community's need for electricity exceeds the amount which could be produced from the level of operations needed to meet the community's thermal needs. In addition, when operations to meet thermal needs result in generation of more electricity than

necessary for the ICES community, the ICES would be able to sell excess electricity to the grid.

ICES may take a variety of forms, from a single owner-user, such as a large industrial complex or university campus, where all energy generated is used by the owner without sales to other customers, to a large residential community in which central power plant produces heat and electricity which is sold at retail to residents of the community. Since successful operation of an ICES presupposes that the ICES will be able to use or sell all energy produced, it can be anticipated that all ICES will at some point seek to sell energy to customers or to the electric utility grid from which the electricity will be sold to customers. By their very nature ICES are likely to be classified as public utilities under the laws of many, or even all, states.

Ross, Hardies, O'Keefe, Babcock & Parsons has undertaken a contract with the Department of Energy to identify impediments to the implementation of the ICES concept found in existing institutional structures established to regulate the construction and operation of public utilities. These institutional structures have been developed in light of policy decisions which have determined that the most effective means of providing utility services to the public is by means of regulated monopolies serving areas large enough to permit exploitation of economies of scale while avoiding wasteful duplication of production and delivery facilities. These existing institutional structures have led to an

energy delivery system characterized by the construction and operation of large central power plants, in many cases some distance from the principal population centers being served.

In contrast, effective implementation of ICES depends to some extent upon the concept of small scale operations supplying a limited market in an area which may be served by other suppliers of utility services. ICES may in many instances involve both existing regulated utilities and a variety of non-utility energy producers and consumers who have not traditionally been subject to public utility type regulation. Implementation of the ICES concept will also require a variety of non-traditional relationships between existing regulated utilities and non-regulated energy producers and consumers.

The purpose of this report is to generally describe the existing scheme of public utility regulation as it is likely to relate to the development and operation of an ICES, the construction of ICES facilities and the determination of relevant cost of service, rate of return and rate structure for the sale and purchase of energy by an ICES. Attention is given to the problems of the entry of an ICES into an energy market which has traditionally been characterized by a form of regulated monopoly where only one utility has been authorized to provide a particular service in a given area.

This report is one of a series of reports covering the law of each of the 50 states and the federal government and should be read in conjunction with Volume One in this series entitled Community Energy Systems and the Law of Public Utilities: An Overview. That volume provides a national overview of the regulatory programs described in detail for the particular state covered by this report. It also provides an analysis of the impediments to effective implementation of the ICES concept and a series of recommendations for responding to those impediments. In many jurisdictions legal issues similar to those likely to arise in the implementation of the ICES concept have not previously been faced. Thus, this series of reports cannot give definitive guidance as to what all of the answers are with respect to all issues which may face ICES implementation. However, by having an understanding of the issues which may arise in the course of an effort to implement ICES, an ICES developer will be better equipped to seek solutions.

Ross, Hardies, O'Keefe, Babcock & Parsons has been assisted in this study by Professor Edmund Kitch, Professor of Law at the University of Chicago Law School; Deloitte, Haskins & Sells, independent public accountants; and Hittman Associates, Inc., engineering consultants.

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We wish to acknowledge the efforts of numerous individuals who have assisted in the preparation of the series of reports which make up the Study of the Impacts of Regulations Affecting the Acceptance of ICES. A number of lawyers and paralegal personnel of Ross, Hardies, have assisted in the research, writing, critiquing, rewriting, proofreading and other efforts including Drew Kaplan; Linda Arbetman; Cheryl K. Hachman; Barbara L. Ross; Joel F. Bonder; Sally H. Newton; Susan N. Stearns; Richard F. Babcock; Donald W. Graves; Theda C. Snyder; Patricia J. Crowe; Susan E. Merritt; Eileen A. Muench; Elizabeth West; Catherine B. Lipscomb; Margaret R. Hessler; and Elizabeth Walter.

Preparation of reports covering regulatory programs in every state has taken considerable research effort and we are grateful to a group of law students who spent not only countless hours in libraries, but also a great deal of time on telephones contacting public officials around the country to secure information about utility regulatory programs. Among the students were Marchall Seeder; Carl Anderson; Locke E. Bowman, III; James G. Bullard; Bruce W. Dewald; Norman B. Julius; Bruce S. Klafter; Ruth B. Kleiman; Suzanne Metzel; Terrence J. Molinari; Alison Moss; Rose M. Urban; Garth D. Wilson; Linda Yi; Shell Bleiweiss and Neal Heriaud.

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CHAPTER 1
EXECUTIVE SUMMARY

I. REGULATION OF PUBLIC UTILITIES

The authority of regulate public utilities in Utah is vested generally in the Public Service Commission (Commission), which is comprised of three members appointed by the governor, with the consent of the senate, to serve for terms of six years. Local governments retain authority only over municipally-owned utilities.

The Commission exercises regulatory authority over public utilities, which are defined by statute to include every gas, electrical or heat corporation performing services for the public. An electrical corporation includes any corporation, cooperative or person owning or controlling any electric plant or otherwise furnishing electric power to the public and a heat corporation includes any corporation or person owning or controlling any heat plant for public service. The Commission may regulate the production, generation, transmission, delivery or furnishing of electricity or artificial heat. The receipt of compensation by a utility is not necessary for Commission jurisdiction. The Commission has authority over both direct and indirect sales. Non-profit cooperatives are not subject to Commission jurisdiction since they do not serve the public generally. Also exempt from Commission authority is the generation of electricity solely for the producer's use or use by his tenants.

The Commission is empowered to regulate, among other

things, initiations or extensions of service, standards of service, rates, systems of accounts, depreciation accounts, issuances of securities and construction of new facilities.

Certificates of public convenience and necessity must be obtained by all public utilities prior to beginning construction or operation of a line, plant or system. Certificates are not required for extensions into areas already served or contiguous to such territory. The Commission's policy has been to grant exclusive certificates in order to avoid competition among utilities.

After an application for a certificate of public convenience and necessity is filed, the Commission will hold a hearing. The only established criterion for evaluating applications for certificates pertains to electrical corporations and requires that the applicant's ratio of debt capital to equity capital be such as to render the applicant financially stable. Other factors often considered include the public need for service, the feasibility of the proposed service and the financial capability of the applicant. The Commission may attach conditions to its grant of a certificate. The Commission also has the authority to approve abandonments of service,

II. SITING OF ENERGY FACILITIES

The State of Utah has not enacted a comprehensive law governing the siting of energy facilities, leaving that authority to several state and local agencies.

County and municipal governments affect the siting of energy facilities by means of their general zoning powers. The Bureau of Environmental Health requires that a person or corporation obtain a permit prior to constructing any facility that may discharge wastes into the state's waters or air. The Energy Conservation and Development Council grants permits for energy resource development projects. The State Engineer's permission is required before a person may use any unappropriated public water.

III. FRANCHISING OF PUBLIC UTILITIES

The authority to grant franchises for the use of public streets and places in connection with providing utility service in Utah is vested by the state constitution and statutes in the local governments.

Franchises are generally granted pursuant to the general statutory requirements for the valid adoption of a municipal ordinance. A certificate of public convenience and necessity is not a prerequisite to obtaining a municipal franchise. The statutes and decisions are silent on the conditions or qualifications for granting a franchise.

Perpetual franchises are prohibited by the Utah Constitution. The statutes, however, do not expressly limit the duration of franchises for providing electricity to the public. A limit of three years is placed on franchises for the furnishing of gas or electric light for public buildings, streets and alleys.

The statutes do not expressly prohibit or permit the grant of an exclusive franchise. A municipality may revoke a franchise for failure to comply with an express condition.

IV. UTILITY RATE REGULATION

The statutes of Utah vest authority to regulate the rates of public utilities in the Commission. This authority extends only to investor-owned and cooperative utilities, and not to those municipally-owned. The Commission has prescribed the NARUC system of accounts for gas and electric companies. The Commission also has the authority to fix the depreciation rates of public utilities operating in the state.

Any proposed change in rates must be filed with the Commission. The Commission, after a hearing, may suspend, alter or amend the filing. Pending the Commission's determination, the proposed rates are suspended for a period not to exceed 120 days, or if the hearing is still pending, an additional 120 days. Two exceptions exist to these procedures. A utility may increase fuel charges due to fuel cost increases upon a showing and tentative decision by the Commission that the increase is justified. Electric cooperatives may implement new rates if the charge has been approved by the cooperative's board of directors, a public hearing has been held prior to implementation, the new rates are filed with the Commission and the new rates do not result in a realized rate of return in excess of 7% on the jurisdictional rate base.

Rates must be just and reasonable. In determining

a utility's rate base, the Commission will generally accept either an historical or estimated test period and will value the utility's property using original cost less depreciation.

Recently, the Commission has noted that the inclusion of construction work in progress will be based upon the financial and cash flow needs of the utility and the need to attract outside financing. When CWIP is included in rate base, an allowance for funds used during construction is likely to be excluded. Property held for future use is generally included in rate base. However, costs incurred in preliminary surveys and investigations of sites which are not eventually purchased or in drilling non-productive wells are excluded from rate base.

The general test for inclusion of an investment in a utility's rate base, is whether it is used and useful in the provision of service. In reviewing allocation of rate base methodologies used by a utility, the Commission considers factors such as fairness, consistency and stability. No particular methodology is preferred by the Commission.

The general test for inclusion of expenses is that they be fair and reasonable. While all telephone company advertising expenses are included, promotional advertising by electric and gas utilities is specifically excluded. Charitable contributions and dues are also generally excluded. Research and development costs are consistently included in a utility's cost of service.

The three criteria of fairness, consistency and stability used to allocate investment in plants are also used to allocate expenses. No particular methodology is preferred by the Commission.

The Commission permits utilities to normalize accelerated depreciation and the investment tax credit. Many other benefits, however, must be flowed through.

In arriving at an overall rate of return, the Commission generally uses a cost of capital method. The Commission uses its "best informed judgment" to set a return on equity. The Commission has cited several factors as justification for a higher than normal rate of return, including rapid growth, cost of new plant construction and high interest rates.

In allocating costs among customer classes, the Commission considers demand on peak system requirements, efficiency of system use, and other relevant usage and load characteristics. The Commission has authorized lifeline rates for senior citizen residential users.

The Commission has the authority to control the issuance of securities by electrical corporations except for those issuances that will mature within one year or comprise less than 5% of the par value of the utility's outstanding shares.

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CHAPTER 2

REGULATION OF PUBLIC UTILITIES IN UTAH

I. PUBLIC AGENCIES WHICH REGULATE PUBLIC UTILITIES

The authority to regulate public utilities is vested generally in the Utah Public Service Commission (Commission). The Commission is comprised of three members appointed by the governor with the consent of the state senate. Commission members are appointed for six year terms and must be free from employment and pecuniary interests incompatible with the duties of the Commission.^{1/}

The Commission is charged with the general supervision of public utilities,^{2/} but its authority does not extend to municipally-owned utilities.^{3/} Local governments are forbidden from exercising any regulatory powers over public utilities unless the utility is municipally-owned.^{4/}

II. JURISDICTION OF THE COMMISSION

The Commission's jurisdiction extends to all "public utilities," which are defined to include:

every gas corporation, electrical corporation [or] . . . heat corporation . . . where the service is performed for, or the commodity delivered to, the public generally, or in the case of a gas corporation or electrical corporation where the gas or electricity is sold or furnished to any member or consumers within the state of Utah for domestic, commercial or industrial use. And whenever any . . . gas corporation, electrical corporation [or] . . . heat corporation performs a service for or delivers a commodity to the public; or in the case of a gas corporation or electrical corpora-

tion selling or furnishing gas or electricity to any member or consumers within the state of Utah, for domestic, commercial or industrial use, for which any compensation or payment whatsoever is received, such . . . gas corporation, heat corporation . . . is hereby declared to be a public utility, subject to the jurisdiction and regulation of the commission and to the provisions of this title. Except, as hereinafter provided, when any person or corporation performs any such service for or delivers any such commodity to any public utility herein defined, such person or corporation, and each thereof, is hereby declared to be a public utility and to be subject to the jurisdiction and regulation of the commission and to the provisions of this title. 5/

An "electrical corporation" is defined to include:

every corporation, cooperative association, and person owning, controlling operating or managing any electric plant, or in anywise furnishing electric power for public service or to its consumers or members for domestic, commercial or industrial use, within this state. 6/

An electric plant includes all real estate, fixtures and personal property used in connection with the production, generation, transmission, delivery or furnishing of electricity for light, heat or power. 7/

A "heat corporation" is defined as "every corporation and person . . . owning, controlling, operating, or managing any heating plant for public service 8/ A heating plant includes all real estate, fixtures, machinery, etc. used in connection with the production, generation, transmission, delivery or furnishing of heat. 9/

The specific activities subject to the Commission's jurisdiction are identified in the definitions of the services under its jurisdiction. The Commission may regulate the "production, generation, transmission, delivery or furnishing"

of electricity or artificial heat. The facilities subject to the Commission's jurisdiction are also identified in the definitions of the jurisdictional services. The definitions of electric and heating plants include all real or personal property, fixtures and machinery used in connection with the production, transmission, generation, delivery or furnishing of the jurisdictional services.

The Commission has statutory authority only over persons and corporations.^{10/} These terms are defined to exclude municipalities,^{11/} and therefore the Commission lacks jurisdiction over municipally-owned utilities.

"Public utility" is defined in such a manner that the receipt of compensation for a utility service is not essential to Commission jurisdiction. Commission jurisdiction can be based solely on the furnishing of a commodity to members or consumers. The relevant definitions provide no basis for a distinction between direct and indirect sales. The Commission is charged with regulating all rates.^{12/} The Commission must authorize the purchase of surplus energy by a public utility from any entity which is not a public utility.^{13/} These provisions demonstrate a legislative intent that the Commission exercise control over both direct and indirect sales. A Commission spokesman confirmed that the Commission does regulate both direct and indirect sales of energy to the public.^{14/}

Commission jurisdiction is based generally on service, or delivery of a commodity to the public generally.^{15/} In the case of gas or electrical corporations the sale or furnishing

of gas or electricity, for which any compensation is received, will definitely subject the corporation to Commission regulation. The statute does not define what constitutes the "public generally." The Utah Supreme Court considered the requirement that service be provided to the public generally in holding that a non-profit electric cooperative was not a public utility subject to Commission regulation.^{16/} The court stated that the fact that the cooperative had sought widespread membership and had denied membership to no one who sought it was immaterial. The court reasoned that a utility became a public utility only if it held itself out as willing to serve the public indiscriminately rather than a definable group. The number of customers actually served was not held to be relevant in determining whether a utility was a public utility.

The definition of "electrical corporation" exempts from regulation the generation and distribution of electricity which is solely for the producer's use, or for the use of tenants. To qualify for the exemption the electricity must be generated on and distributed through private property alone, i.e. property not dedicated to public use.^{17/} This exemption was construed narrowly by a federal Court of Appeals in a private antitrust action.^{18/} This case involved a shopping center owner who constructed a generating plant on his property to supply energy to the center's tenants. The Court of Appeals found that the center provided its services to the public who patronized the shopping center as well as its

tenants and was thus not exempt from Commission regulation. In response to this decision, the Commission held that the shopping center owner was a public utility subject to its jurisdiction. On appeal, the Utah Supreme Court held that the federal court's holding was not final remanded the case to the Commission for a determination of whether the electricity was generated and distributed solely on private property and was used only by the shopping center owner and his tenants. If the facts required affirmative answers to these questions, the Commission was directed to hold that the center owner is not subject to Commission jurisdiction.^{19/} The Commission held that the center owner was not a public utility subject to its jurisdiction.^{20/}

III. POWERS OF THE COMMISSION

The Commission is vested with power and jurisdiction to supervise and regulate all of the business of every public utility in Utah.^{21/} In addition, the Commission may "do all things . . . which are necessary or convenient" in the exercise of its powers.^{22/} These general powers, when combined with its specific powers, provide the Commission with a broad base from which to regulate all activities of public utilities.

The Commission also has several specific grants of authority over the operations of public utilities. The Commission must approve most initiations or extensions of service,^{23/} and may establish standards of service.^{24/} It has authority to regulate rates,^{25/} to establish a system of accounts to be used

by public utilities,^{26/} and to require public utilities to carry a proper depreciation account.^{27/} In addition, the Commission must approve the issuance of securities by electrical corporations,^{28/} and the construction of new facilities or extensions of existing facilities.^{29/}

IV. AUTHORITY TO ASSIGN RIGHTS TO PROVIDE SERVICE IN A GIVEN AREA

A. Generally

A public utility is required to obtain a certificate of convenience and necessity before it may establish, or begin construction or operation of a line, plant or system.^{30/}

"Construction" is not defined by statute. No certificate is necessary, however, for an extension of facilities by a public utility into areas already served by it and necessary in the ordinary course of business or for extensions by a utility into areas contiguous to its territory and not already being served by a utility offering the same service.^{31/}

B. Competition

A grandfather clause provision permits the Commission to grant an exclusive certificate to utilities that were serving customers prior to the enactment of Title 54.^{32/} In addition, the Commission's policy has been to grant exclusive service areas to public utilities in order to avoid potentially ruinous competition.^{33/} A Commission spokesman stated that the sole exception to the policy against competition has been in the area of common carriers.^{34/} The Commission has informally considered a proposal for a steam-extraction project that

would generate electricity, and would be situated in an area that is already receiving utility service. A spokesman for the Commission stated that it wishes to promote this type of development and would certify it despite the fact that it would engender competition.^{35/}

C. Certificating Procedures

An applicant for a certificate of public convenience and necessity must file with the Commission evidence that it has obtained any necessary franchise or permit from the local body governing the area to be served.^{36/} The Commission, after a hearing, may approve the application if it finds that the proposed construction or operation will serve the public convenience and necessity. The Commission may attach to the exercise of the rights granted by the certificate any necessary terms or conditions.^{37/} A Commission spokesman indicated that beyond this statutory requirement, the Commission is very flexible with respect to the procedure to be followed in obtaining a certificate.^{38/}

In addition to the general requirement that any new operations or construction be required by the public convenience and necessity, the only statutory criterion for the granting of a certificate pertains only to electrical corporations and states that the applicant's ratio of debt capital to equity capital be such that it, in the opinion of the Commission, renders the applicant financially stable.^{39/} The Commission has considered the question of what constitutes an

acceptable debt to equity capital ratio, and has not set a rigid standard. In one case, the Commission indicated that an equity component of at least forty percent of a company's capital structure as sufficient evidence of financial stability.^{40/} In another case, the Commission rejected an application for a certificate filed by a company which had 5.5 percent equity capital.^{41/}

Other criteria utilized by the Commission in granting a certificate have been summarized in its opinions as follows:

1. Whether there is a need, demand, or necessity by the general public for the proposed service in the area sought to be served;
2. Whether the proposed service is economically feasible, financially sound, efficient, stable and continuing;
3. Whether the application is physically and financially capable of providing the service proposed; and
4. Whether the effect of granting a certificate to the company would be detrimental to other existing suppliers. ^{42/}

In addition, the Supreme Court of Utah has offered a definition of "necessity" in the context of a certificate application.

"Necessity" is a public need without which the public would be inconvenienced or handicapped in the pursuit of business or pleasure. In ascertaining necessity, one should look to the future as well as the present, providing for probable growth of population, industry, and community development. If a new and enlarged service will enhance the public welfare to the extent that the patronage received will justify the expense of rendering it, the old service is not adequate.^{43/}

D. Service Area Disputes

Any public utility which claims to be injuriously interfered with by another public utility may complain to the Commission. The Commission, after a hearing, may issue any order and prescribe any terms and conditions which are reasonable with respect to the disputed operations or construction. ^{44/}

E. Abandonment of Service

The Commission has authority under its general jurisdiction to approve petitions for abandonment. ^{45/} No specific procedure is provided for obtaining approval of an abandonment of service and no statutory criteria are provided for the approval of an abandonment.

Several Commission cases involving common carriers have cited language from a federal case in considering petitions to abandon public utility service.

A public utility cannot, in the absence of contract, be compelled to continue to operate its utility at a loss. . . . The corporation, although devoting its property to the use of the public, does not do so irrevocably or absolutely, but on condition that the public shall supply sufficient traffic on a reasonable rate basis to yield a fair return, and if at any time it develops with reasonable certainty that future operations must be at a loss, the corporation may surrender its franchise, discontinue operation, and dismantle and sell its physical properties. ^{46/}

V. APPEALS OF REGULATORY DECISIONS

Before any court may hear an appeal of a Commission decision, an application must be made for a rehearing of the matter. The application for rehearing must be made prior to

the effective date of the order or decision appealed from, or if the order becomes effective prior to twenty days after its date, application can be made up to twenty days after the order or decision.^{47/}

Within thirty days after the application for a rehearing is denied, or within thirty days after the rendition of a decision on rehearing, the applicant or any party aggrieved by such order may apply to the Supreme Court of Utah for a writ of certiorari. No other court in the state has jurisdiction to review a Commission decision.^{48/} Appeals to the Supreme Court of Utah from Commission decisions are preferred on the Court's calender over all other civil cases.^{49/}

Appeals are heard on the certified record of the Commission, and no new or additional evidence may be introduced. Judicial review is limited to a determination of whether the Commission has regularly pursued its authority, including a determination of whether the order or decision under review violates any rights of the petitioner under the state and federal constitutions.^{50/}

FOOTNOTES

1. Utah Code Ann. §54-1-1.5 (Smith 1974).
2. Id. §54-4-1 (Smith Supp. 1979).
3. Id. §54-2-1(3) (Smith 1974).
4. Utah Const. art 11, §5 (1974).
5. Utah Code Ann. §54-2-1(30) (Smith 1974).
6. Id. §54-2-1(20).
7. Id. §54-2-1(19).
8. Id. §54-2-1(16).
9. Id. §54-2-1(15).
10. Id. §§54-2-1 (Smith 1974), 54-4-1 (Smith Supp. 1979).
11. Id. §54-2-1(3).
12. Id. §54-7-12(1) (Smith Supp. 1979).
13. Id. §54-2-1(30) (Smith 1974).
14. Mr. Victor Gibb, Executive Secretary, Commission, Telephone conversation, 8/23/78.
15. Utah Code Ann. §54-2-1 (Smith 1974).
16. Garkane Power Co. Inc. v. Public Serv. Commn., 98 Utah 466, 100 P.2d 571 (1940).
17. Utah Code Ann. §54-2-1(20) (Smith 1974).
18. Cottonwood Mall Shopping Center Inc. v. Utah Power & Light Co., 440 F.2d 36 (1971).
19. Cottonwood Mall Shopping Center, Inc. v. Public Service Commission, 558 P.2d 1331 (Utah 1977).
20. Cottonwood Mall Shopping Center, Inc., Docket No. 7166 (Utah P.S.C. Apr. 5, 1977).
21. Utah Code Ann. §54-4-1 (Smith Supp. 1979).
22. Id. §54-4-1.
23. Id. §54-4-25 (Smith 1974).
24. Id. §54-4-7.
25. Id. §54-7-12 (Smith Supp. 1979).

26. Id. §54-4-23 (Smith 1974).
27. Id. §54-4-24.
28. Id. §54-4-31 (Smith Supp. 1979)
29. Id. §54-4-25 (Smith 1974).
30. Id. §54-4-25 (1).
31. Ibid.
32. Id. §54-4-25(4).
33. Re Wells E. Streeper P.U.R. 1924 B. 393 (Utah P.S.C.).
34. Mr. Victor Gibb, Executive Secretary, Commission,
Telephone conversation, 8/23/78.
35. Id.
36. Utah Code Ann. §54-4-25(3) (Smith 1974).
37. Ibid.
38. Mr. Victor Gibb, Executive Secretary, Commission,
Telephone conversation, 8/23/78.
39. Utah Code Ann. §54-4-25(4) (Smith 1974).
40. Re Utah Power & Light Co., 76 P.U.R. 3d 1 (1968).
41. Re Dixie Rural Elec. Co., 64 P.U.R. 3d 481
(1966).
42. Re Utah Power & Light Co., 76 P.U.R. 3d 1 (1968).
43. Mulcahy v. Pub. Serv. Commn., 101 Utah 245,
251, 117 P.2d 298 (1972) (A certificate was issued to
a trucking firm to operate between Salt Lake City
and Ogden over challenges by two rail companies.
The trucking firm offered pickups at intermediate
points and other services that the rail companies did
not offer).
44. Utah Code Ann. §54-4-25 (1) (Smith 1974).
45. Re Emigration Canyon R.R. Co., P.U.R. 1917 F.464.
46. Phillips v. Nelson, 34 P.U.R. NS 378, 108 F.2d 725
(1939). See also Re Bamberger and Tooele Stage Lines,
4 P.U.R. 3d 377 (1954) (Both cases indicated, however,
that substitute service should be considered in order
to protect the interests of the customers of the utility
seeking to abandon service).

47. Utah Code Ann. §54-7-15 (Smith 1974).
48. Id. §54-7-16.
49. Id. §54-7-18.
50. Id. §54-7-16.

CHAPTER 3

SITING OF ENERGY FACILITIES IN UTAH

The state of Utah has not enacted a comprehensive law governing the siting of energy facilities. Consequently, various state and local agencies may have separate approval authority over the siting of such facilities.

I. PLANNING AUTHORITIES

County and municipal governments in Utah are vested with general zoning powers, e.g. to regulate and restrict the height and size of buildings, density, location and use of structures and land for trade, industry, residence or other purposes. ^{1/} District regulations are to be in accordance with a master plan. ^{2/} Master plans may be adopted by local governing bodies which may include the planning of the general location and extent of public utilities and terminals, whether publicly or privately owned.

II. ENVIRONMENTAL AGENCIES

A. Bureau of Environmental Health

The Bureau of Environmental Health (Bureau) is primarily concerned with alleviating the health hazards of environmental pollution. Within the Bureau, the Committee on Water Pollution is responsible for controlling pollution of the state's waters. It is unlawful for any person, without first obtaining a permit from that committee, to construct or operate any establishment which would cause an increase in the discharge of wastes, or would alter the physical properties of any waters of the state. ^{3/}

The Bureau's Air Conservation Committee (Committee) has permitting authority with respect to air pollution. The Committee requires that notice be given by any person planning to construct a new installation which might reasonably be expected to be a source of air pollution. The Committee may review the plans and specifications of the proposed establishment. If it is determined from the plans that the proposed construction will not be in accord with the state's air pollution rules and regulations, an order prohibiting the construction is to be issued.^{4/}

B. Department of Natural Resources

The Department of Natural Resources is comprised of several boards, which manage public lands and resources.^{5/} These boards do not have the authority to issue permits for construction activities.

C. Energy Conservation Development Council

The Utah Energy Conservation and Development Council has advisory and policy-making functions relating to energy conservation and development. Among its duties, the Council is to develop criteria for consideration by state agencies in the granting of permits for "energy resource development projects."^{6/} This term, however, is not defined in the Act.^{7/}

III. UTAH STATE ENGINEER

A person who wishes to acquire the right to use any unappropriated public water in Utah must secure permission to do so from the State Engineer. An application to use un-

appropriated public water must state: the nature of the proposed use for the water; the quantity of water to be appropriated; the name and place of the stream or other source of the water and the nature of the diverting works; and the nature of the diverting channel.^{8/} The State Engineer must approve an application if: (1) there is unappropriated water in the proposed source; (2) the proposed use will not impair existing rights, or interfere with the more beneficial use of the water; (3) the proposed plan is physically and economically feasible; and (4) the applicant has the financial ability to complete the plan and the application was filed in good faith.^{9/}

FOOTNOTES

1. Utah Code Ann. §§10-9-1 et seq.; §§17-27-1 et seq. (Smith 1973).
2. Id. §§10-9-3, 17-27-4.
3. Id. §73-14-5 (Smith Supp. 1979).
4. Id. §26-24-9 (Smith Supp. 1979)
5. Id. §63-34-1 (Smith 1978 and Smith Supp. 1979)
6. Id. §63-53-4 (d) (Smith 1978)
7. Ibid.
8. Id. §73-3-2 (Smith Supp. 1979).
9. Id. §73-3-8.

CHAPTER 4

FRANCHISING OF PUBLIC UTILITIES IN UTAH

I. EXPRESS AUTHORITY TO GRANT FRANCHISES

Express authority to issue franchises is conferred upon local governments in the Utah Constitution. One article provides municipalities with the power to "grant local public utility franchises and within its powers regulate the exercise thereof."^{1/} Another article states that: "no law shall be passed granting the right to construct and operate a street railroad, telegraph, telephone, or electric light plant within any city or incorporated town, without the consent of the local authorities who have control of the street or highway proposed to be occupied for such purposes."^{2/} The scope and relationship of these two sections of the Utah Constitution has not been discussed in any judicial decision.

Additional grants of franchising authority are found in the Utah statutes. Municipalities in Utah are granted the power to:

Construct, maintain, and operate water-works, sewer collection, sewer treatment systems, gas works, electric light works, telephone lines or public transportation systems, or authorize the construction, maintenance, and operation of the same by others, or purchase or lease such works or systems from any person or corporation

. . . . 3/

The Supreme Court of Utah has stated that it could find "no specific provision in the Constitution nor the statutes

dealing with franchises."^{4/} The Court went on to state that the power of a municipality to grant franchises must emanate, if at all, from the statutory provision quoted above. Further express franchising authority for specific services is provided by the following statutes:

[All cities] may contract with and authorize any person, company or association to construct gas works, electric or other lighting works within the city, and give such persons, company or association the privilege of furnishing light for the public buildings, streets, sidewalks and alleys of the city for any length of time not exceeding three years. 5/

[All cities] may provide for the lighting of streets and the erection of necessary appliances and lamp posts; may regulate the sale and use of gas, natural gas and electric or other lights and electric power within the city, and regulate the inspection of meters therefor; may prohibit or regulate the erection of telegraph, telephone or electric wire poles in the public grounds, streets or alleys, and the placing of wires thereon; and may require the removal from the public grounds, streets or alleys of any or all such poles, and the placing underground of any or all telegraph, telephone or electric wires. 6/

Cities are also given the power to "regulate and control the use of sidewalks and all structures thereunder or thereover,"^{7/} and the power to "prevent injury or obstruction to any street, sidewalk, avenue, alley, park or public ground."^{8/}

The relationship between the Public Utilities Commission and a municipality was discussed in Union Pac. Ry. Co. v. Public Service Comm'n.^{9/} That case held that the Public Utilities Act "even with its broad grant of power to the Commission to regulate and supervise public utilities,

did not repeal by implication the power granted to municipalities to control by franchise the special burdening of their streets."^{10/} The Commission has exclusive jurisdiction over rates and other matters, but municipalities have exclusive jurisdiction regarding the special use of their streets, giving them the power to grant franchises and to exercise continuing control over their franchises.^{11/}

II. PROCEDURES FOR GRANTING FRANCHISES

The Utah statutes do not contain any provisions which specify a procedure for granting public utility franchises. Such grants are made pursuant to the general statutory requirements for the valid adoption of a municipal ordinance.^{12/} No judicial decisions add to the general procedural requirements for adopting an ordinance. An example of the franchise ordinance procedure may be found in Union Pac. Ry. Co. v. Public Service Comm'n.^{13/}

The Utah statutes require a utility to present evidence of municipal consent to its operations before the Public Utilities Commission will issue a certificate of public convenience and necessity.^{14/} Procurement of a certificate is therefore not a prerequisite to obtaining a municipal franchise.

III. CRITERIA TO BE USED IN EVALUATING A FRANCHISE

The statutory authority to grant franchises does not expressly limit the grant of franchises to services which are offered to the public. The statutes, however,

(see Part I) list specific types of utility services which may be authorized to operate within a municipality. The statutes and judicial decisions are silent as to the conditions and qualifications of municipal franchises.

IV. CHARACTERISTICS OF A FRANCHISE

A. Duration and Termination

The Utah statutes and cases do not impose general limits on the duration of a utility franchise. The statutes do place a limit of three years on franchises for the furnishing of gas or electric light for public buildings, streets, sidewalks, and alleys.^{15/} The relevant section, however, does not deal with the duration of franchises for the provision of electricity for public consumption.

Perpetual franchises are prohibited by the Utah Constitution. Article I of the Constitution provides that no law shall be passed granting irrevocably any franchise, privilege or immunity.^{16/} There is no authority in either the statutes or judicial decisions for the automatic surrender of a franchise.

B. Exclusivity

The statutes do not expressly permit or prohibit the grant of an exclusive franchise. The granting of exclusive franchises was forbidden in municipalities when Utah was a territory.^{17/} More recently, however, in Burton v. Matanuska Valley Lines, the court stated that:

[I]t is by no means clear what this language of the 1886 enactment was intended to pro-

hibit . . . territorial legislatures from recognizing that public utilities are natural monopolies and providing for regulation of such utilities by means comparable to that commonly provided by state legislators, which often find that such public utilities may best be regulated by making them monopolies. 18/

The Utah Supreme Court has implied that a franchise which is exclusive by its terms would constitute an illegal monopoly. The Court did not state this conclusion expressly because the franchise in question was not expressly exclusive, and could not be construed as exclusive by unavoidable implication. 19/

C. Other Characteristics

The statutes do not make any provision for the abandonment of a franchise. The Commission has authorized the discontinuance of a street railway system before the operator's franchise had expired. The railway was unprofitable, had no prospects for improvement, and was to be replaced by a bus line. The Commission reasoned that it was empowered to issue such an order because the municipality which granted the unexpired franchise was a political subdivision of the state, and in granting the franchise was acting as an agent of the state. 20/

A municipality may revoke a franchise for failure to comply with an express condition of the franchise. 21/ There is express statutory authority for a municipality to require removal of the tracks of a railway franchise where such

franchise has been revoked.^{22/} There is no statute regarding the removal of facilities of other utilities upon expiration of a franchise.

In Mountain States Telephone & Tel. Co. v. Ogden City,^{23/} the ordinances granting franchises to telephone, gas, and electric utilities provided that the utilities were to pay 2% of their gross revenue derived from sales within the city limits to the city. Such payments were to be "in lieu of" other taxes and charges. It was held that the city had no power to enter into the "in lieu of" provisions of the franchise and that the city could not "barter away its power to raise revenue by taxation."^{24/} The court further held that it was reasonable and not discriminatory to levy an additional tax on these utilities, and not others, since they comprised "a distinct class of businesses within the public utility field."^{25/}

There is no provision in the statutes for the imposition of a mandatory franchise tax.

FOOTNOTES

1. Utah Const. art 11 §5(b).
2. Utah Const. art 12, §8.
3. Utah Code Ann. §10-8-14 (Smith 1973).
4. Mountain States Tel. & Tel. Co. v. Ogden City, 28 Utah 2d 190, 487 P.2d 849 (1971) (Plaintiffs challenged the validity of an ordinance imposing a business tax upon public utilities).
5. Utah Code Ann. §10-8-20 (Smith 1973).
6. Id. §10-8-21.
7. Id. §10-8-23.
8. Id. §10-8-24.
9. 103 Utah 186, 134 P.2d 469 (1943).
10. Id. 134 P.2d at 476.
11. Ibid.
12. Utah Code Ann. §§10-3-701 to 714 (Smith Supp. 1979).
13. 103 Utah 186, 134 P.2d 469 (1943).
14. Utah Code Ann. §54-4-25(3) (Smith 1974).
15. Id. §10-8-20 (Smith 1973).
16. Utah Const. art. 1, §24.
17. Henderson v. Ogden City Ry. Co., 7 Utah 199, 26 P.2d 86 (1891).
18. Burton v. Matanuska Valley Lines, 244 P.2d 647 (9th Cir. 1957).
19. Brummitt v. Waterworks Co., 33 Utah 285, 93 P. 828 (1908) (Water users challenged a city ordinance which raised the rates to be charged by the defendant water company. One contention was that the 50-year ordinance under which the company operated was an illegal monopoly).
20. Re Utah Light & Traction Co., P.U.R. 1927 A 310 (1927).
21. Union Pac. Ry. Co. v. Public Service Comm'n, 103 Utah 186, 134 P.2d 469 (1943).

22. Utah Code Ann. §10-8-82 (Smith 1973).
23. 26 Utah 2d 190, 487 P.2d 849 (1971).
24. Id. 487 P.2d at 850.
25. Id. 487 P.2d at 851.

CHAPTER 5

RATE REGULATION IN UTAH

I. RATEMAKING AUTHORITY

A. General

In addition to its general supervisory and regulatory powers over every public utility in the State of Utah and its general supervisory power over all the business of every such public utility,^{1/} the Utah Public Service Commission (Commission) has, inter alia, specific statutory authority to regulate the utilities' records and accounts,^{2/} their depreciation accrual rates,^{3/} and their rates and charges for service.^{4/} By definition, the scope of these powers includes all investor-owned utilities and electric cooperatives; it does not include government-owned utilities.^{5/} Conversely, local governments cannot regulate utilities regulated by the Commission.

The Commission's jurisdiction over the books and records of public utilities is similar to that of other state commissions, and pursuant thereto, the Commission has adopted the system of accounts promulgated by the National Association of Regulatory Utility Commissioners (commonly known as NARUC) for gas and electric companies.^{6/} This system of accounts classifies utilities by type and size, with less stringent record-keeping required of smaller utilities. As the Utah Commission has recognized, "[w]ith

a few exceptions this system of accounts and the one prescribed by the Federal Power Commission [now the Federal Energy Regulation Commission] are the same."^{7/}

The Commission's jurisdiction over depreciation accounts, also very similar to that of other state commissions, includes the power to fix a utility's depreciation accrual rates for the various classes of property of the utility.^{8/} The statute also provides that a depreciation fund shall be provided for out of earnings and that this fund and the income therefrom can be spent only for such purposes and under such rules and regulations as the Commission may prescribe. This provision, as many of the existing statutes, was enacted in 1917 as part of the Utah Public Utility Act (which created the Commission) and has not since been amended. Given modern accounting practices it is unlikely that the Commission would require a "depreciation fund" per se although accounting for depreciation (via a charge to operating expenses and the accumulation of a depreciation reserve) would be required by the NARUC system of accounts.

B. Ratemaking Procedures

The Commission's control over the rates charged by public utilities is effectuated by a number of statutory provisions. First, each utility is required to file with the Commission, and to keep open for public inspection, its

rates and "all rules, regulations, contracts, privileges and facilities which in any manner affect or relate to rates, tolls, rentals, charges, classifications or service."^{9/} A utility must charge "just and reasonable rates"^{10/} and cannot grant "any preference or advantage to any person, subject any person to any prejudice or disadvantage or establish or maintain any unreasonable difference as to rates or service."^{11/} It must also charge the rates it has filed with the Commission.^{12/}

No change can be made in a utility's filed rates except upon 30 days' notice to the Commission.^{13/} This notice, which may be waived by the Commission, is accomplished by filing with the Commission and keeping open for inspection new schedules plainly showing the changes to be made.^{14/} If the initial establishment of rates and regulations is involved, or if a proposed change does not involve an increase in rates, then the filing would become effective after 30 days, subject to the Commission's power, after a hearing held on its own motion or upon complaint, to suspend, alter or amend the filing.^{15/}

However, if the utility's filing effectuates an increase in rates, then such rates do not become effective until the expiration of 120 days from the date of filing.^{16/} If the Commission has begun a hearing on the increased rates and that hearing cannot be completed within the 120-day

period, then the Commission may extend the effective date by an additional 120 days, and issue a temporary order^{17/} authorizing interim relief pending a final decision.

There are two statutory exemptions to the procedure for establishing increased rates: (1) for increases^{18/} in rates due to increases in fuel costs; and, (2) for rate changes of electrical cooperatives.^{19/} The first exemption would allow an increase in fuel charges due to fuel cost increases of independent fuel suppliers, upon a showing before and a tentative decision by the Commission that an increase in charges is justified. Thereafter a public hearing on the increased charges must be held within 30 days of the tentative decision.

The statutory exemption from rate-setting procedures for electrical cooperatives is much broader. Electrical cooperatives (defined as entities "organized for the purpose of distributing electricity to its members and the public at cost [which shall include interest costs and the rate of return as prescribed hereinafter]") may implement new schedules of rates or other changes that result in new rates if:

1. The change has been approved by the cooperative's board of directors or any appropriate agency of the federal

government;

2. Prior to implementation of increased rates the electric cooperative has held a public meeting for all of its customers and members, after affording notice, by mail, of the meeting;
3. The schedule of new rates is filed with the Commission and made available by the Commission for public inspection; and
4. Any increase in rates does not result in a realized rate of return in excess of 7 percent on jurisdictional rate base. In the event an electric cooperative earns more than 7 percent, then it must promptly notify the Commission, which may take such action as it deems appropriate.

In addition to the procedural provisions applicable to a rate filing made by a utility or electric cooperative, the Commission may investigate at any time, the rates charged by a utility (including electric cooperatives), and after notice to the utility and a hearing, determine the fair and reasonable rates.

C. Statutory Factors in Determining Rates

As previously stated, by statute a utility's rates must be "just and reasonable," a utility cannot "establish or maintain any unreasonable difference as to rates and service," and when reviewing a utility's rates, whether upon application, complaint, or its own motion, the Commission is required to determine the "just and reasonable" rates. There are two statutory provisions which provide some guidance as to the scope of the terms "just and reasonable" in Utah. First, in 1975 the Commission's ratemaking powers were revised to include the provision that:

(3) The [C]ommission, in its determination of just and reasonable rates, may consider recent changes in the utility's financial condition or changes reasonably expected, but not speculative, in the utility's revenues, expenses or investments and may adopt an appropriate future test period, not exceeding twelve months from the date of filing, including projections or projections together with a period of actual operations in determining the utility's test year for ratemaking purposes. 21/

Secondly, in 1977 the provision requiring public utilities (including electrical cooperatives) to charge just and reasonable rates was amended to provide:

The scope of definition 'just and reasonable' may include, but shall not be limited to, the cost of providing service to each category of customer, economic impact of charges on each category of customer, and on the well being

of the State of Utah; methods of reducing wide periodic variations in demand of such products, commodities or services, and means of encouraging conservation of resources and energy. 22/

Hence, the Commission may now clearly use a projected test year to determine the reasonableness of a utility's rates and a utility when designing rates and presumably the Commission when reviewing them should consider the cost of service for each category of customers, the economic impact of its charges on each category of customers and on the well being of the State of Utah, and the use of rate structures which will reduce wide periodic variations in demand and will encourage conservation.

II. RATE BASE DETERMINATION

A. Test Year

As previously indicated, the Commission has specific statutory authority to consider a forecasted test year so long as the test period is not beyond twelve months from the date of filing of increased rates. 23/ In general, the Commission 24/ will accept either a historical or estimated test period. The Commission recognizes that some degree of speculation is inherent in the use of a forecasted test year and cannot be avoided. 25/ It has yet to reject a projection as too speculative. 26/ The Commission has indicated that when, during a proceeding, actual data becomes available, then it will be 27/ used to test the accuracy of a company's forecasts.

B. Rate Base Valuation

The Utah statutes authorize the Commission to ascertain the value of a utility's property, a responsibility it has fulfilled by consistently using original cost less depreciation to determine the rate base.^{28/} The Commission generally uses an average rather than year-end rate base for the reason that because "revenue and expense figures cover the entire twelve months in the test period . . . it is appropriate to relate such figures to an average . . . rate base."^{29/}

C. Rate Base Components and Adjustments

Due to the use of a forecasted test year, the Commission can allow a return on investment in plant not in service at the date of filing increased rates. Therefore, a utility can attempt to synchronize increases in rates with increases in its plant in service thereby avoiding one of the causes of attrition. However, this does not solve the problem posed by funds advanced for investment in plant which will not be placed in service (i.e., used and useful) during the forecasted test year.

The Commission's policy with respect to construction work in progress (CWIP) has changed over the last 20 years from one of total exclusion prior to the late 1960's^{30/} to inclusion of certain amounts. From the late 1960's to 1979 the Commission included all CWIP in rate base when a utility

was not engaged in construction programs "of long duration and of great magnitude like the construction of steam generating stations."^{31/} However, in 1979, when considering the rate relief to be granted to the state's largest electric utility, which was engaged in a large construction program for additional generating units, the Commission held that the inclusion of CWIP would be based upon the financial and particularly the cash flow needs of the utility and its need to attract outside financing.^{32/} This recent expression of the Commission's policy on CWIP was prompted by a decision of the Utah Supreme Court, which, when remanding a case to the Commission on other grounds, commented that:

It may well be that in the operation of such a public utility there is necessity for some reasonable amount of CWIP in taking care of normal depreciation and obsolescence; and perhaps finance a reasonable and necessary expected normal growth. But the proposition to be wary of is that a utility should not be able to impose upon its present customers the burden of financing the expansion of its growth by charging rates greater than are needed to provide a reasonable return upon the capital structure required to provide them. ^{33/}

On remand the Commission, in a lengthy analysis of the problems posed by CWIP, reasoned that when inclusion of CWIP is determined by reference to the financial needs of a utility (i.e., "its minimum cash requirements to maintain its financial integrity and to attract outside capital")^{34/} then:

the allowance for CWIP does not present a question of whether the ratepayer pays now or pays later. The problem is one of whether the ratepayer pays now in the form of a return on CWIP or pays now in the form of an allowance provided by some other regulatory tool that is subject to adjustment, most typically the allowed return on common equity. ^{35/}

Given this choice, the Commission found that it prefers inclusion of CWIP in rate base because it slightly lowers future rates and produces a gradual rate increase even when plant accounts increase greatly and suddenly. ^{36/}

Therefore, after reviewing the bond ratings, market to book ratios, interest coverages and most importantly, the cash flow and level of internal generation of cash of the utility in question, the Commission found that sixty percent of the utility's jurisdictional CWIP (\$110 million out of a total of \$183.5 million) was "a reasonable amount necessary to satisfy the minimum cash needs for internal cash generation and other requirements for a sound financial condition as can be fully justified." ^{37/}

When adopting its "financial integrity" test for inclusion of CWIP the Commission observed that while "[i]t is appropriate to view cash flow and other financial needs . . . on a jurisdictional basis . . . it is unreasonable for this Commission to fail to consider the regulatory treatment accorded to . . . [a utility] in its other jurisdictions and its impact upon the capital costs paid by the Utah customers." ^{38/}

Therefore, the Commission observed that both the Idaho and FERC jurisdictions are rather "rigid and fixed" and that "neither is willing to recognize what we consider to be the legitimate cash needs" of the electric utility in question.^{39/} The Commission indicated that such policies by the other commissions could tend to dilute the effect of Utah regulation relating to cash flow and that this fact would be considered in determining the cash needs of the utility. The Commission also indicated that when determining the amount of CWIP to include in rate base it would take into consideration a disproportionate rate of growth in the utility's other jurisdictions.^{40/}

Finally, in this decision the Commission also implicitly indicated a change in recognizing for ratemaking purposes the allowance for funds used during construction (AFUDC). Formerly when including CWIP in rate base, the Commission would also include as earnings for ratemaking purposes the amount of AFUDC charged to that construction during the test year.^{41/} Hence, as the Commission recognized, only the difference between the allowed rate of return and the interest rate used for AFUDC was provided for in a utility's rates.^{42/} Depending on the similarity between the interest rate used for AFUDC and the allowed rate of return, investors could continue to receive no or very little immediate

compensation for capital advanced to construct plant.

However, when adopting a financial integrity test for inclusion of CWIP the Commission noted that the AFUDC interest rate is approximately equal to a utility's cost of capital as determined by a state commission.^{43/} It also stated that:

when CWIP is included in rate base for ratemaking purposes, AFUDC is not capitalized in the assets accounts
The effect of allowing CWIP in rate base, however, is to require the ratepayer to pay all of the carrying costs . . . for the CWIP allowed [in rate base] ^{44/}

Thus, it would appear that when CWIP is included in rate base, AFUDC is no longer capitalized and hence would no longer be included in earnings for ratemaking or financial reporting purposes.

While the allowance for a return on investment in plant under construction had been somewhat problematical, the allowance of a return on property held for future use generally has not. Property held for future use is usually included in rate base, particularly when, in accordance with NARUC system of accounts, the property is owned and held for future use in utility service under a definite plan for such use.^{45/} Thus, a return has been allowed on: the cost of land acquired for possible generating plants and substations, the cost of obtaining a state permit for a water reservoir and the cost of coal prospecting rights and water drilling rights related to a possible steam generating station;^{46/}

the cost of unexplored leasehold interests in land in connection with a gas exploration and production program^{47/} and, future plant sites, coal properties and uranium properties of an electric company.^{48/} The Commission has also held that where property held for future use has been included in rate base, then any subsequent profits or gains realized from the sale or use of the property for purposes other than its intended use should be used to reduce the utility's cost of service.^{49/}

While the cost of land or land rights (e.g. drilling rights) held for future use is included in rate base, costs incurred in preliminary surveys and investigation of sites which are not purchased or for drilling non-productive wells are not.^{50/} Pursuant to the system of accounts for gas companies, exploration and development costs are recorded as a deferred debit.^{51/} If the investigated site is acquired or a well is productive then the acquisition-related expenditures or the drilling costs recorded in the deferred account are added to the cost of the investment and included in rate base.^{52/} Assuming a depreciable asset, the utility thereby receives a return of the exploration and development expenditures, by way of charges to depreciation expense, as well as a return on those expenditures during the service of the asset. If the land is not acquired or a well is unproductive, then the

deferred account is written off by charges to the account for exploration and development expenses,^{53/} which can be included in test year expenses for ratemaking purposes.

D. Allocation of Rate Base

With the exception of CWIP and property held for future use the general test for inclusion of an investment in a utility's rate base is whether it is "used and useful" in the provision of service to which the proposed rates will be applicable. Investment in facilities which are devoted to a nonutility service is not included in a utility's rate base. Thus, the Utah Commission has excluded a telephone company's investments in special communications facilities used for service to the Department of Defense and in a microwave system used to provide service to a cable television operator.^{54/} Similarly, investments in oil facilities have^{55/} been excluded from the rate base of a natural gas utility.

While the Utah Commission's policy regarding exclusion of costs incurred by a utility for the provision of nonutility service is clear, its policy regarding the appropriate methodology to allocate common or joint facilities and costs is purposely amorphous. In a recent electric utility rate case involving an electric utility providing service regulated by three different commissions (Utah, Idaho and FERC) the Commission recognized that the process of allocating

common facilities or joint costs is "very involved and requires a great deal of informed judgment," that the "end result has a critical impact on the jurisdictional operating return and rate base used by us in setting rates" and that, because, by definition, common or joint facilities and costs cannot be specifically identified and quantified for any particular jurisdiction, any number of allocation methodologies can be equally correct.^{56/} Therefore, the Commission concluded that its objectives when reviewing allocation methodologies used by a utility are:

(1) Fairness. The allocations should be derived from the most reasonable set of assumptions possible that attempt to assign costs to the jurisdictions and customers that cause such costs taking into account demands on peak system requirements, efficiency of system use and other relevant usage and load characteristics.

(2) Consistency. The allocation factors and methodology should be consistent among the jurisdictions to ensure that all expenses and rate base are considered for ratemaking purposes, and that no revenue is double counted.

(3) Stability. The allocation methods should produce reasonably stable results and changes over time should be made only as cost and usage relationships change.^{57/}

The Commission expressly took no position as to whether, in achieving fairness in assigning costs among various jurisdictions, historical average costs, incremental or marginal costs or some other measure of costs is appropriate.^{58/} It also stated that the objective of consistency was only workable if other

jurisdictional regulatory bodies are willing to utilize allocation methods "reasonably consistent" with those the Utah Commission finds reasonable.^{59/}

In the case under consideration the Commission found that there was little evidence justifying the use of either the peak responsibility method or the sum of the monthly peaks method in order to allocate production and bulk transmission plant and expressly refused to approve or disapprove either method.^{60/} Nonetheless the Commission made no changes in a utility's allocations because the utility had used a methodology (sum of the monthly peaks) which had been adopted by the other two commissions regulating the company's rates.^{61/}

In an earlier case involving the same electric utility the Commission accepted the following methodologies:

- (1) Geographic location for transmission lines, substations, distribution plant, franchises and consents pertaining to a particular community, general plant not allocated on the basis of firm power requirements, contributions in aid of construction and customer advances, accumulated deferred state income taxes;
- (2) Firm power requirements for production plant, general plant consisting of office buildings,

- warehouses, pole yards, coal mine properties and general office production, transmission, transportation and communication equipment, plant held for future use, franchises and consents not allocated on the basis of geographic location;
- (3) Net operating revenues for accumulated deferred federal income taxes;
 - (4) Operating expenses for working capital;
 - (5) Accumulated provisions for depreciation, depletion, and amortization were allocated on the same basis as related plant.^{62/}

III. COST OF SERVICE

A. Allowable Expenses

In general the Commission accepts, without discussion, the revenues and expenses submitted by the utilities in support of their rate filings. However, there are four categories of expenses which have received particular attention: (1) advertising expenses; (2) charitable contributions; (3) research and development expenses; and (4) expenses arising from transactions with affiliates. The general test for inclusion is whether the expenses are "fair and reasonable,"^{63/} a test which allows the Commission to base its decision on the circumstances faced by a particular utility or type of

utility.

For example, all advertising expenses of a telephone utility are included in the cost of service.^{64/} However, promotional advertising expenses or "any expense which is in any manner connected with a direct or indirect promotional effort" by a gas or electric utility are excluded from the cost of service.^{65/} Advertising expenses incurred by gas and electric utilities which can be included in the cost of service are:

- (1) Advertising for the purpose of encouraging conservation of energy . . . and providing instructions or suggestions helpful to the consumer in achieving such conservation.
- (2) Advertising which instructs the consumer on matters of safety in connection with the use of electricity and electric appliances as deemed prudent by Utah Power.
- (3) Reasonable expenses connected with new customer service such as surveying premises, estimating electricity use and needed facilities and processing applications.^{66/}

Charitable contributions and dues and expenses for membership in service clubs are consistently excluded from the cost of service of all types of utilities.^{67/}

In general, the Commission has recognized the need to encourage vigorous exploration and development programs by energy utilities. Hence research and development expenses are consistently included in a utility's cost of service.

In particular, the Commission has allowed inclusion of payments made by (1) a telephone operating subsidiary to an affiliate engaged in research;^{68/} (2) expenses of a gas distribution company incurred in a joint exploration and development program with an affiliate engaged in a non-utility oil business;^{69/} and (3) dry hole losses and the costs of abandoned leases of a gas company engaged in an exploration and development program.^{70/} However, on one occasion the Commission indicated that the programs will be encouraged so long as the costs incurred in developing new supplies are lower than the average cost of purchasing supplies.^{71/}

Finally, the Commission has found fair and reasonable payments made by a telephone operating company to its parent corporation for financial, legal, research, and other services where there was evidence that the price paid for those services was less than that charged by independent suppliers and where the value of the services provided was not less than the price paid for them.^{72/}

B. Allocation of Expenses

The three criteria of fairness, consistency and stability used to allocate investment in plant are also used to allocate expenses. Likewise, the Commission has not adopted any particular methodology for allocating expenses, but reviews all of the evidence presented and exercises its own independent judgment as to the appropriate result.

For example, in a rate case brought by a natural gas company, which also engaged in non-utility oil operations, the Commission was presented with three different methodologies for allocating administrative and general expenses. The company's allocation was based upon the ratio of direct labor expense between the utility and non-utility operations, approximately one percent non-utility to 99 percent utility. Another party looked at the ratios between the utility and non-utility gross plant investment, gross revenues, interest allocation, and the capital budget. It recommended that 8 to 14 percent of administrative and general expenses should be allocated to non-utility operations. A third party used the ratio of investment in non-utility operations to total operations and recommended the allocation of 14 percent to non-utility operations. The Commission adopted none of these methodologies but, after reviewing the evidence and exercising its judgment, determined that a more appropriate ratio was 10 percent.^{73/}

In the same case the Commission was also presented with three different methods for allocating exploration and development expenses. The company, using a method adopted by the Commission in a previous case, allocated 67.12 percent of its exploration and development expenses to its gas operations and the balance to oil. Another party decided that the most relevant factors for allocation of these costs were

the value of the reserves of each operation and the exploration cost incurred to produce those reserves and recommended that 43.9 percent of the test year exploration expenses be to the gas utility. A third party reviewed 12 factors which were not specified in the Commission's decision, ultimately concluded that six of them were more relevant to determining the allocation ratio and on the basis of this study, personal experience and judgment, concluded that the exploration and development expenses should be borne equally by both operations (i.e. 50 percent were allocated to the gas utility and 50 percent to the oil operation). The Commission concluded:

We are not anxious to adjust this allocation at frequent intervals, but we are persuaded that in fairness to both the ratepayer and the investor that . . . [the third] approach is the most exhaustive study ever presented to this Commission on this subject and its application in this case will result in the fairest and most reasonable allocation of this expense between the utility and non-utility operations. Further, we are hopeful that this allocation will be sufficiently satisfactory to all parties concerned so as to rest this issue for some period of time for the future. 74/

Thus, although adopting a new allocation, the Commission indicated that it not only strives for consistency between regulatory jurisdictions but also for consistency from case to case, even though the potential of over or under recovery due to inconsistency in allocation methods among various

regulatory agencies may not be present.

IV. FEDERAL INCOME TAX ISSUES

A. Accelerated Depreciation

All utilities that request to normalize accelerated depreciation may do so.^{75/} Further, where a telephone utility did not use accelerated depreciation for tax purposes, the Commission decided "not to impute the use of accelerated depreciation in determining the income tax expense to be allowed in the total cost of service."^{76/} The Commission added, however, that the

increase in revenues to be allowed [would] be based upon the low end of what we find to be a reasonable range in rate of return, and if the petitioner desires to move its earnings to the higher end of such range it has the opportunity to do so by utilizing accelerated depreciation for tax purposes on a flow-through basis.^{77/}

B. Investment Tax Credits

All utilities may normalize the investment tax credit.^{78/} For example, post 1971 investment tax credits were normalized and "each accounting period . . . credited with a ratable portion of the credit over the life of the property which gave rise to the credit."^{79/}

No recently reported decisions have dealt with treatment of pre-1971 and post-1970 investment tax credits. However, in 1969 the Commission held that the reduction in taxes due to the then existing investment tax credit (i.e.,

pre-1971 investment tax credits) should be flowed through.^{80/}

C. Other Tax Timing Differences

The Commission does not permit full normalization of all tax timing differences. Current tax benefits from some items such as construction related expenses are flowed through instead.^{81/}

V. METHODS USED FOR DETERMINING THE RETURN TO BE ALLOWED A REGULATED UTILITY

In general the Commission, in arriving at the overall rate of return, uses a cost of capital method, whereby the cost of attracting debt and equity capital is determined and then applied to an appropriate capital structure.^{82/} The cost of debt capital and preferred stock is determined by calculating the weighted average cost of the utility's outstanding long term debt and preferred stock.

The Commission does not use any particular method or combination of methods to set a return on equity. Rather, it uses its "best informed judgment" in an attempt to meet certain standards:

Adequate earnings are necessary to allow Midland to provide the quantity and quality of service demanded by its customers. The return should be sufficient to insure investor confidence in the financial soundness of the utility and sufficient to maintain its credit and enable it to raise the money necessary for the proper discharge of its duties. At the same time, the earnings should not be as high as those that might be

realized or anticipated by highly profitable enterprises or speculative ventures. 83/

The Commission has considered at least one form of the comparable earnings method to be unreliable. Thus, in a telephone rate case, the Commission indicated that "comparisons of the earnings of a public utility with those of groups of nonregulated industrial companies do not afford reliable criteria from which a proper rate of return on . . . equity . . . may be ascertained."^{84/}

In an electric utility case, the Commission set the return on equity at 16 percent, so that the sale of additional common stock would net at least the book value of that stock. The Commission explained that

should the commission allow or order the company to proceed with its construction and if earnings not be allowed sufficient to bring its stock to at least book value such sales of needed securities would result in a confiscation of existing shareholders' interests in the company. The commission has a duty to avoid this confiscation. 85/

The Commission recognizes that "the ability of a utility to earn a satisfactory coverage of this interest requirement is an important consideration," especially when high interest rates prevail.^{86/} Only an extremely high return on equity, however, can ensure an "ideal" interest coverage ratio when the utility is highly leveraged. The Commission has conceded, therefore, that "in the future it will be

extremely difficult for the natural gas industry to maintain interest coverage multiples as high as they have been in the past."^{87/}

The table in Appendix A indicates the overall return and return on equity allowed in recent rate cases.

The Commission has cited several factors as justification for a higher than normal rate of return. These factors include rapid utility growth, cost of new plant construction and resulting need for additional capital, and high interest rates.^{88/} The Commission has refused, however, to increase a utility's rate of return to compensate for attrition.^{89/} Although wage rates had spiraled, material costs had decreased, "[M]arket price, earnings and dividends per share [had] increased at substantially faster rates than did the Consumers Price Index."^{90/} Moreover, test period expenses had been adjusted for all known increases, and CWIP had been included in the rate base. Therefore, no attrition allowance was needed.

VI. RATE DESIGN CRITERIA

A. Rate Structure

As previously indicated the Utah Code states that all utility charges and related regulations must be "just and reasonable."^{91/} In establishing rates, the Commission seeks to allocate costs in a reasonable manner to the customers

who cause such costs.^{92/} In doing so, the Commission considers "demand on peak system requirements, efficiency of system use, and other relevant usage and load characteristics."^{93/} Historical average or marginal costs may be used, depending on the particular circumstances.^{94/} However, although the Commission has approved rate structures based on the cost of service,^{95/} it may consider other factors as well.

For example, the Commission has acknowledged that the charges of a telephone utility "should be designed to recognize the cost to provide services and the value received by the customer."^{96/} Admitted difficulties in measuring costs and value of service did not alter the Commission's position.

The Commission has authorized life-line rates for senior citizen residential users of an electric utility.^{97/} According to the approved rate structure, heads of households over the age of sixty-five would not "receive any increase in rates for the first 400 kwh prorated on a 30 day billing period."^{98/} The Commission found that the rates of return from the proposed senior citizen class and other residential classes were not so disparate as to be discriminatory.^{99/}

The Commission noted, in addition, that relative rates of return would not be changed significantly by the new rate structure.^{100/}

B. Pricing of Excess Power

When reviewing the rates of Utah Power & Light the Commission discussed the pricing of excess electric power generated by the applicant and sold to Arizona Public Service Co. Under the sales contract, Utah Power & Light Co. agreed to furnish 100,000 kilowatts of power by expanding its generating facilities.^{101/} The expected price would "permit Utah Power to recover all of its variable costs, including fuel, and to recover all of the fixed charges relating to the \$11.8 million incremental investment required to expand the capacity of the generating facilities."^{102/}

Although the Commission approved the contract, it expressed "considerable doubts" about the use of incremental pricing for out-of-state contracts. Under the pricing scheme adopted, out-of-state customers could purchase power at a cost lower than that paid by Utah residents. Pricing based on average investment per kilowatt, on the other hand, would have generated higher utility revenues and, therefore, lower rates for Utah customers. The Commission concluded that

if large amounts of excess capacity were to be sold at a price computed on the incremental methods used in the Arizona contract such sales could be detrimental to the Utah customers of the applicant.

Accordingly, . . . any future contracts for the sale of power to any customer or other utility, either in and out of the state of Utah, if the applicant intends to use any facilities or allocate a portion of any facilities over which this commission has jurisdiction, shall not be entered into without the prior written approval of this commission. 103/

In the same case, the Commission noted that Utah Power expected to soon become a net exporter of power. To do so, the utility would need to "invest almost one billion dollars during the next five or six years for additions to its electric system."^{104/} While the Commission supported the projected construction program, it expressed concern that the utility might be forced to "dump" excess power at an artificially low price. Therefore, the Commission directed the utility to

attempt to enter into contracts for the sale of any excess capacity that will recover all of its direct expenses and a reasonable return on the investment on the facilities involved and further that it obtain the best price possible for any "dump" power which it sells to other utilities. ^{105/}

VII. ISSUANCE OF SECURITIES

The Commission is granted the authority to control the issuance of securities by electrical corporations.^{106/} No electrical corporation may issue any security, nor shall any electrical corporation assume any obligation or liability as guarantor, endorser, surety or otherwise, in connection with any security of another person relating to the financing of pollution control revenue bonds, without prior written approval of the Commission. Authorization of the Commission is not required for the issuance or renewal of a note or draft

maturing not more than one year after the date of the issue or renewal and aggregating not more than five percent of the par value of the other securities of the electric utility then outstanding. 107/

APPENDIX A

<u>CASE</u>	<u>ALLOWED %</u>	<u>RATE OF RETURN</u>
	<u>OVERALL</u>	<u>ON COMMON EQUITY</u>
<u>Re Utah Gas Serv. Co.,</u> <u>28 P.U.R.4th 129 (1978)</u>	13.88	15.00
<u>Re Utah Power & Light Co.,</u> <u>Case No. 78-035-14,</u> <u>Aug. 17, 1978</u>	10.23	14.00
<u>Re Mountain Fuel Supply Co.,</u> <u>23 P.U.R.4th 346 (1977)</u>	9.55	13.25
<u>Re Mountain States Tel. &</u> <u>Tel. Co., Case No. 76-049-04,</u> <u>Sept. 13, 1977</u>	9.38	13.00
<u>Re Utah Power & Light Co.,</u> <u>Case No. 76-035-06,</u> <u>Aug. 22, 1977</u>	10.25	14.50
<u>Re Mountain States Tel.</u> <u>& Tel. Co., Case No.</u> <u>I & S 170, May 27, 1976</u>	9.74	12.75
<u>Re Utah Power & Light Co.,</u> <u>14 P.U.R.4th 161 (1976)</u>	10.71	16.00
<u>Re Mountain Fuel Supply Co.,</u> <u>13 P.U.R.4th 232 (1975)</u>	9.47	11.84
<u>Re Utah Gas Serv. Co.,</u> <u>11 P.U.R.4th 314 (1975)</u>	10.60	15.00
<u>Re Utah Power & Light Co.,</u> <u>Case No. 7088, Feb. 13,</u> <u>1975</u>	8.79	13.25

FOOTNOTES

1. Utah Code Ann. §54-4-1 (Smith Supp. 1979).
2. Id. §54-4-23 (Smith 1974).
3. Id. §54-4-24.
4. Id. §54-4-4.
5. Id. §54-2-1.
6. Rules and Regulations, Utah Commission, Rules A67-05-78 and A67-05-79.
7. Utah Power & Light Co., 6 P.U.R. 4th 263, 277 (1974).
8. Utah Code Ann. §54-4-24 (Smith 1974).
9. Id. §54-3-2(2).
10. Id. §54-3-1 (Smith Supp. 1979).
11. Id. §54-3-8 (Smith 1974).
12. Id. §54-3-7.
13. Id. §54-3-3.
14. Ibid.
15. Id. §54-7-12(3) (Smith Supp. 1979).
16. Id. §54-7-12(2).
17. Ibid.
18. Id. §54-7-12(1).
19. Id. §54-7-12(4).
20. Id. §§54-4-2, 3 (Smith 1974).
21. Id. §54-4-4(3) (Smith Supp. 1979).
22. Id. §54-3-1.

23. Id. §54-4-4(3).
24. C. Mower, Assistant Manager of Utility Accounts and Finance, Commission, Telephone Conversation, 9/13/79 (hereinafter "Mower Conversation").
25. Re Mountain Fuel Supply, 13 P.U.R. 4th 232, 234-235.
26. Mower Conversation.
27. Re Mountain Fuel Supply 23 P.U.R. 4th 346, 348 (1977).
28. Re Mountain States Tel. & Tel. Co., 78 P.U.R. 3rd 429, 435 (1969); Argus Utility Scope Regulatory Service, Basic Analysis (Utah), Feb. 1979 at 5; Mower Conversation.
29. Re Mountain States Tel. & Tel. Co., supra, note 28 at 436.
30. Re Mountain States Tel. & Tel. Co., 23 P.U.R. 3rd 125 (1958).
31. Re Utah Power & Light, Case No. 7161, May 2, 1979, mimeo at 12, note 6.
32. Id. at 18.
33. Utility Consumer Action Group v. Utah Pub. Serv. Comm'n, 583 P.2d 605, 608 (1978).
34. Re Utah Power & Light Co., Case No. 7161 at 18.
35. Ibid.
36. Id. at 19.
37. Id. at 36.
38. Id. at 20.
39. Ibid.
40. Id. at 20-21.
41. Re Mountain States Tel. & Tel. Co., 78 P.U.R.3d 429.
42. Ibid.

43. Re Utah Power & Light Co., Case No. 7161, supra, at 9-10.
44. Id. at 10.
45. Re Utah Power & Light Co., 6 P.U.R.4th 263, 277 (1974); Re Utah Power & Light Co., Case No. 7161, supra at 32.
46. Re Utah Power & Light Co., 6 P.U.R.4th 263, 276.
47. Ibid.
48. Re Mountain Fuel Supply, 23 P.U.R.4th 346, 352 (1977); Re Utah Gas Service Co., 11 P.U.R.4th 314, 323 (1975).
49. Re Utah Power & Light Co., Case No. 7161, supra at 33.
50. Ibid.
51. Re Utah Gas Service Co., 11 P.U.R.4th 314, 322, 324 (1975); Re Mountain Fuel Supply Co., 23 P.U.R.4th 346, 352 (1977).
52. 11 P.U.R.4th 314, 324.
53. Ibid.
54. Re Midland Tel. Co., 89 P.U.R.3d 288, 290-291 (1971).
55. Re Mountain Fuel Supply Co., 76 P.U.R.3rd 277, 312 (1968).
56. Re Utah Power & Light Co., Case No. 7167, supra, mimeo at 29.
57. Id. at 29-30 (footnotes deleted).
58. Id. footnote 11.
59. Id. footnote 12.
60. Id. at 31.
61. Ibid.
62. Re Utah Power & Light Co., 6 P.U.R.4th 263, 274-275, 278 (1974).

63. See, e.g., Re Mountain States Tel. & Tel. Co., Case No. 76-649-04, July 14, 1977, mimeo at 13; Re Mountain Fuel Supply Co., 23 P.U.R.4th 346, 355 (1977).
64. Mower Conversation.
65. Re Mountain Fuel Supply Co., 13 P.U.R.4th 232, 239 (1975).
66. Re Utah Power & Light Co., 6 P.U.R.4th 263, 289 (1974).
67. Re Mountain States Tel. & Tel. Co., 78 P.U.R.3d 429, 439 (1960).
68. Re Mountain States Tel. & Tel. Co., Case No. 76-049-04, July 14, 1977, mimeo at 14.
69. Re Mountain Fuel Supply Co., 23 P.U.R.4th 346, 355 (1977).
70. Re Utah Gas Service Co., 11 P.U.R.4th 314, 330 (1975).
71. Re Mountain Fuel Supply, 76 P.U.R.3d 277, 284 (1968).
72. Re Mountain States Tel. & Tel. Co., Case No. 76-049-04, supra; Re Mountain States Tel. & Tel. Co., 78 P.U.R.3d 429, 434 (1969).
73. Re Mountain Fuel Supply, 13 P.U.R.4th 232, 238239 (1979).
74. Id. at 241.
75. Mower Conversation. See e.g., Re Utah Power & Light Co., Case No. 7167, May 2, 1979, mimeo at 14; Re Utah Power & Light Co., 14 P.U.R.4th 161, 165 (1976).
76. Re Mountain States Tel. & Tel. Co., 78 P.U.R.3d 429, 443 (1969).
77. Ibid.
78. Mower Conversation.
79. Re Utah Power & Light Co., 6 P.U.R.4th 263, 291 (1974).
80. Re Mountain State Tel. & Tel. Co, 78 P.U.R.3d 429, 444 (1969).
81. Mower Conversation.

82. E.g., Re Utah Power & Light Co., 6 P.U.R.4th 263, 284 (1974).
83. Re Midland Tel. Co., 89 P.U.R.3d 288, 299 (1971).
See also Re Utah Power & Light Co., 6 P.U.R.4th 263, 284 (1974).
84. Re Mountain States Tel. & Tel. Co., 78 P.U.R.3d 429, 449 (1969).
85. Re Utah Power & Light Co., 14 P.U.R.4th 161, 166 (1976).
86. Re Utah Gas Serv. Co., 11 P.U.R.4th 314, 328 (1975).
87. Ibid.
88. Re Mountain States Tel. & Tel. Co., 78 P.U.R.3d 429, 449 (1969).
89. Id. at 450.
90. Ibid.
91. Utah Code Ann. §54-3-1 (Smith Supp. 1979).
92. Re Utah Power & Light Co., Case No. 7167, May 2, 1979, mimeo at 20.
93. Ibid.
94. Id. at 29, footnote 11.
95. See, e.g., Re Utah Gas Serv. Co., 28 P.U.R.4th 129, 135 (1978); Re Mountain Fuel Supply Co., 76 P.U.R.3d 277, 305-12 (1968).
96. Re Mountain States Tel. & Tel. Co., Case No. 7010, Jan. 21, 1975, mimeo at 3.
97. Re Utah Power & Light Co., 27 P.U.R.4th 334, 344 (1978).
98. Id. at 335.
99. Id. at 341.
100. Id. at 342.

101. Re Utah Power & Light Co., 6 P.U.R.4th 263 (1974).
102. Id. at 270.
103. Id. at 272.
104. Ibid.
105. Ibid.
106. Utah Code Ann. §§54-4-31 (Smith Supp. 1979).
107. Ibid.

CHAPTER 6

SUMMARY OF IMPEDIMENTS TO IMPLEMENTATION OF ICES

I. Types of Impediments

In order to analyze the extent to which the traditional public utility regulatory system may impede the implementation of ICES, one must first identify what is meant by the word "impediment." For the purposes of this analysis, four broad types of impediments can be identified. The first major category of impediment is the "no-subsidy impediment." This impediment consists of the failure of the government or the regulatory system to provide some desired degree of monetary or other encouragement of ICES. Such subsidies could take the form of grants or tax incentives. On the other hand, a subsidy could result from state public utility regulatory commission (PUC) departure from strictly cost-based rates for purchases and sales of electricity between an ICES and conventional electric utilities, thereby compelling the customers of the electric utility grid to subsidize ICES.

The second major category of impediment is the "uncertainty impediment." The absence of certainty with respect to the manner in which an ICES will be regulated will impose costs that must be borne by the ICES operator. Uncertainty impediments will appear in many forms. ICES will be faced with uncertainty because it represents a new concept which can be

expected to raise issues with which utility regulators are unfamiliar. Such uncertainties will be aggravated as a result of the fact that regulatory jurisdiction in the United States is decentralized. Thus, these uncertainties will have to be resolved largely on a jurisdiction-by-jurisdiction basis. In addition, ICES will necessarily be involved in the sale of excess electrical power to and the purchase of back-up electrical power from conventional electric utilities. These arrangements, however, can be altered by a PUC even though the ICES and utility initially agreed upon the terms. Therefore, ICES will face transactional uncertainties not normally encountered in doing business outside the utility field.

Another major category of impediment is the "discriminatory impediment." This type of impediment takes the form of rules or regulations which, for whatever reasons, affect ICES more harshly than competing energy technologies. These differences in impact may be the result of any number of factors including, but not limited to, ICES size, the type of customers it can be expected to serve and the manner in which it will do business.

The final general category of impediment is the "prohibition impediment." These impediments could be either regulations which impose so substantial a cost on the ICES that it cannot operate economically or regulations which would actually preclude operation of an ICES.

II. Regulatory Impediments to ICES Implementation

The degree and manner in which the existing regulatory system will impede the development of ICES will vary depending on the form of ownership, class of customer and method of doing business chosen by an ICES developer. The ICES type which can be expected to encounter the most serious impediments is the investor-owned ICES seeking to construct a new facility to serve customers in a community already being served by a conventional utility. Such an ICES will face impediments in the form of general PUC regulation, regulations relating to the siting of facilities and the granting of local franchise and regulations concerning rates charged for energy service.

A. General Regulatory Impediments

Public utility regulation probably is more pervasive and complex than any other form of government regulation of business. A businessman not engaged in the utility business may be reluctant to become involved in a business which will subject him to such pervasive governmental regulation. Some examples of areas of regulation which might discourage investors from becoming involved in ICES implementation are the requirement that a regulated utility maintain its books in conformity with a system of accounts prescribed by the PUC and PUC regulation and scrutiny of the financial affairs of the utility. When the ICES is operated in conjunction with a non-utility business, such regulation necessarily will extend beyond the operator's utility operations and involve PUC examination of

its non-utility business. Attempts at minimizing the effects of these types of impediments by setting up a subsidiary corporation to own and operate the ICES could subject the parent company to extensive Securities and Exchange Commission regulation pursuant to the Public Utility Holding Company Act of 1933.

Even if an ICES developer is willing to face the possibility of extensive PUC regulation, it will face a significant uncertainty in determining whether it will be deemed a public utility and therefore subject to PUC regulation. All states require that a utility provide service "to or for the public" before it becomes subject to the jurisdiction of the PUC. Few states, however, have provided any real guidance with respect to the meaning of the phrase "to or for the public." Thus, an ICES operator can expect very little guidance in determining whether its operations will be sufficient to bring it within the classification of "public utility."

Similarly, many states require that a utility "sell" utility service before it will be classified as a public utility. Again, statutes, administrative rules and caselaw provide very little guidance with respect to when a transaction will be classified as a "sale." Thus, the ICES operator must face another significant area of uncertainty with respect to PUC regulation of its operations.

Assuming that some aspects of the ICES operations will bring it within the classification of public utility, a

serious question remains with respect to whether sales of both of the ICES energy streams will be subject to PUC regulation and, if not, whether and by whom the non-PUC regulated energy stream will be regulated. This uncertainty arises because many state statutory schemes provide for the regulation of only certain enumerated utility services such as heat, electricity and gas. In such states, the provisions of refrigeration or motive power may not be within PUC jurisdiction. Regardless of whether these energy streams will be regulated by local governments, or left unregulated, such split regulation may raise significant problems with respect to the marketing of both energy streams at competitive rates.

State territorial assignment programs could present an impediment capable of precluding operation by ICES. Several states have enacted legislation which specifically provides that the PUC is to divide the state into a finite number of service areas and assign each of these service areas exclusively to a particular utility. Where such programs exist, service area assignments have been made and, generally, these programs make no provision for the assignment of service areas to new utilities unless there is some indication that customers are not being adequately served. Even where no specific statutory allocation scheme exists, PUCs generally have sought in granting certificates of public convenience and necessity to avoid what they viewed as wasteful duplication of facilities by granting the first utility serving a given area in effect an exclusive

right to serve that area so long as the utility provides adequate service. Thus, in many cases, an ICES may find that it is precluded from initiating operations as a result of these territorial assignment programs.

B. Siting Impediments

The siting of energy production facilities is regulated in some manner in all states. The types and degree of impediments presented will vary depending on the type of siting program in effect in a particular jurisdiction and the type of facility proposed to be constructed. In those states which have not adopted comprehensive one-stop siting programs, a utility desiring to construct an energy production facility generally must seek approval from a variety of state and local agencies. Because an ICES developer in such a state will be forced to obtain numerous approvals, the procedural requirements related to obtaining such multiple approvals could present significant impediments to the implementation of ICES. In those states which have attempted to minimize the procedural difficulties presented by the need to obtain multiple approvals by implementing one-stop comprehensive siting programs, an ICES operator may face significant impediments in the form of substantive requirements in obtaining the required approval.

C. Local Franchising Impediments

In addition to obtaining certificates of convenience and necessity from PUCs and siting approvals from one or more state agencies, ICES operators generally will be required to

obtain franchises from local governments to use public rights-of-way for transmission and distribution facilities. Because of the total lack of uniformity in the law and procedures governing local franchising, ICES operators will face many uncertainties in this area. One major uncertainty related to whether a franchise is needed or available and, if a franchise is not available, whether this will preclude the use of public rights-of-way in conjunction with the operation of the ICES. Many franchise enabling statutes list specific services which local governments are authorized to franchise. In addition, most statutes require that the franchisee be serving a public purpose in order to be eligible for a franchise. These types of restrictions raise the question of whether, if an ICES is providing a service which is not deemed to be serving a public purpose, a franchise may be granted. If a franchise cannot be granted, significant uncertainty exists with respect to whether the ICES may operate along public rights-of-way without a franchise. If not, it may be precluded from operating unless all facilities are maintained on private property with the permission of the property owners.

Assuming a franchise is available to an ICES, additional uncertainty exists with respect to the procedure pursuant to which the franchise will be granted and the standards which will be applied in determining whether the franchise should be granted. These procedures and standards vary substantially from state to state and from municipality to municipality within each state.

Finally, an ICES which might otherwise be eligible for a franchise may be unable to obtain the necessary franchise as a result of a prior grant of an exclusive franchise to another utility serving the area. Nearly one-half of the states have not resolved the issue of whether exclusive franchises are permissible.

D. Rate Regulation Impediments

Assuming that an ICES operator can overcome or operate in spite of the impediments described above and begin its operations, it must be able to market both energy streams at competitive rates in order to stay in business. Several areas of PUC rate regulation may impede the ICES' ability to operate profitably. For example, an ICES may find that the rates for one energy stream are regulated on a statewide basis by the PUC while the remaining stream is regulated by one or more local governments. With such split jurisdiction, there can be little assurance that rates will be regulated consistently and in such a way as to enable competitive marketing of both energy streams.

Even if both energy streams are regulated by the PUC, resolution of various cost and rate-base allocation issues could present serious issues unique to ICES. Depending on the method chosen to allocate costs and rate base between the two services being marketed, the ICES operator may find that it will be compelled to sell one energy stream at a rate too low for the whole ICES to be profitable while the second energy stream must be sold at a rate too high to be competitive.

In addition, PUCs traditionally have exercised rate-making authority only with respect to sales by conventional utilities operating in a monopoly market. Investment in these conventional utilities traditionally has been considered a low-risk investment and, therefore, the rates of return on equity permitted by PUCs have been commensurately low. Because ICES, as a new industry and as a utility operating in competition with other utilities, will be viewed as a more risky investment, PUC decisions with respect to allowable rates of return will have a significant impact on the ability of ICES to attract investors. Rates of return satisfactory to investors in conventional utilities are unlikely to attract investors to the more risky ICES operations.

Finally, ICES must be able to obtain reasonable rates for sales of excess electrical power to and purchases of back-up electrical power from conventional electric utilities. These rates also will be regulated by PUCs and the PUC determinations will substantially affect the ability of the ICES to operate profitably. The uncertainty surrounding the factors that will be considered by PUCs in establishing these rates is very likely to be perceived as an impediment by prospective ICES operators and investors.

CHAPTER 7

OVERCOMING IMPEDIMENTS TO ICES -- SUMMARY

The Chapter 6 analysis demonstrates that the traditional public utility regulatory system presents numerous impediments to the implementation of ICES. These impediments do not appear in the form of a list of individual statutory or rule provisions which can be easily modified to accommodate ICES. Rather, the impediments take the form of the existing regulatory system itself -- a system which is based largely on a set of assumptions and practices foreign to the ICES concept.

Because the existing regulatory system is, in effect, the major impediment to the implementation of ICES, there are only two available alternatives for dealing with this impediment. Advocates of ICES can attempt to change the system, or they can work within the system in order to demonstrate the value of the ICES concept. Because many of the regulatory provisions which appear to be impediments to the implementation of ICES are integral parts of the existing regulatory system, however, any effort to change the system sufficiently to encourage the widespread implementation of ICES will require changes so fundamental that traditional forces operating within the system would have little trouble blocking such changes. Thus, a widespread effort by the advocates of ICES to change the system may result in a substantial expenditure of resources while bringing about very little change.

There is no single configuration or form of ICES. While differences can result from employing different technologies to produce different energy streams, the most useful classifications for purposes of analyzing potential institutional impediments to the implementation of ICES are those based on type of owner/developer and the nature of the customer group served. The classification scheme used in the following analyses includes ICES-Utility -- an ICES owned and operated by a conventional electric utility, ICES-Complex -- an ICES designed to serve existing institutional complexes such as government, commercial, industrial, residential or medical centers, ICES-Heat Plant -- an ICES providing thermal service for its own use or the use of a ~~limited~~ class of customers and selling all electrical output to a conventional utility, ICES-Co-Op -- an ICES owned by its customers and serving only these member/customers and ICES-Entrepreneur -- an ICES owned and operated by any entity intending to sell or provide utility service at retail to all users within a particular service area. Obviously, additional types, of ICES can be developed by combining these various modes of ownership with the various available customer classes.

ICES may be established gradually in forms that will not encounter, or not be significantly affected by, many of the impediments discussed above. When the various types of ICES are compared against the existing regulatory framework, it is apparent that there is a wide range in the degree of compatibility

between that framework and the various ICES types. The degree to which the implementation of ICES will be impeded by the existing regulatory system varies greatly depending on the form of ownership of the ICES, the number and type of customers which it intends to serve and the manner in which it will conduct its utility operations. Therefore, if advocates of ICES seek implementation along the paths of least resistance, this gradual implementation will provide ICES technology with an opportunity to establish its viability and adapt to the existing regulatory system while permitting the existing system to become familiar with and adapt to the peculiar problems and benefits of ICES. The following may be the most appropriate sequence of implementation of ICES.

I. ICES-Utility

ICES-Utility would include any ICES owned by an existing electric utility and operated as a part of its existing utility business. The utility could either operate its own cogeneration equipment or operate equipment owned by another entity on behalf of the owner. The utility would carry on its electrical operations in the same manner as it had before becoming involved with the ICES, but the particular arrangements for the sale of thermal energy could vary. Thermal energy might be distributed by the ICES-Utility to individual customers or it could be sold in bulk to a single customer for use by that customer or for further distribution by it.

ICES-Utility, because it would be operated by an existing utility, would be least affected by the regulatory impediments discussed in Chapter 6. As an existing utility, the ICES operator would already be subject to PUC regulatory jurisdiction and would have the experience necessary to function within that system with a minimum of inconvenience. In addition, the ICES-Utility might be able to install and maintain its ICES equipment pursuant to existing franchises, certificates or other approvals or obtain minor modifications in these prior approvals so as to permit the ICES operations.

II. ICES-Complex, ICES-Heat Plant

A second approach would be to structure ICES so as to take advantage of traditional exemptions built into the existing regulatory scheme in most states. In all states, a utility must be providing service "to or for the public" before it will be subject to PUC regulatory jurisdiction. In about half of the states, a utility will be subject to PUC jurisdiction only if it is deemed to be making "sales" of energy service. If the ICES is structured so as to either not be deemed to be providing service "to or for the public" or not to be making "sales" of energy services, that ICES would not be subject to PUC regulatory jurisdiction. ICES-Complex and ICES-Heat Plant would be structured so that energy services would be provided only to a limited and clearly defined class of customers. In addition, in many cases, such ICES may be able to provide energy service

as a part of an over-all rental package rather than on an individual metered basis. Such ICES could, in many cases, avoid classification as public utilities. Examples of such ICES would be an ICES established to serve a residential, industrial, commercial, governmental or university complex.

A great deal of uncertainty exists with respect to what types of service can be provided and to how many customers before a utility will be deemed to be subject to PUC jurisdiction. These uncertainties, however, could be remedied by means of fairly simple legislative or administrative action.

By operating so as to avoid PUC regulatory jurisdiction, these ICES will also give up the protections afforded by the regulatory system. Thus, such ICES may be able to operate in competition with conventional utilities without having to obtain PUC approval, but they also must be capable of waging a competitive battle with the existing utilities in the area to be served because they would not enjoy the luxury of the traditional monopoly status of a public utility. Similarly, such ICES would not be subject to PUC rate regulation but would also possibly not receive adequate regulatory protection in their attempts to negotiate contracts to purchase back-up power from or sell surplus power to conventional utilities.

III. ICES-Co-Op

ICES-Co-Op, unlike the ICES discussed above, could lend itself to broad implementation of ICES. By operating as a

cooperative -- a utility which is owned by its customers and provides service only to these owner/customers -- the ICES-Co-Op could avoid many of the more troublesome aspects of the traditional regulatory system while still enjoying many of its benefits. For example, utility cooperatives are exempted from PUC rate regulation and regulation of financial affairs in many states. On the other hand, utility cooperatives often are subject to service area restrictions and, therefore, are afforded the protections of the various methods of territorial allocations utilized by PUCs.

This traditional utility concept could be utilized by, and modified to better serve, ICES projects intended to serve large numbers of customers. One area of possible modification would be to permit qualifying ICES-Co-Ops to commence operations in service areas of conventional utilities under certain circumstances. Qualifying ICES-Co-Ops could be allowed to serve only large concentrations of new customers or they could be allowed to serve existing concentrations of customers. The prejudicial effect of such an extension of the cooperative concept could be minimized by requiring ICES-Co-Ops to purchase those facilities of the conventional utility within the ICES service area which are necessary for serving the ICES customers and which would be rendered unnecessary to the utility.

IV. Exempt-ICES

By utilizing the ICES types discussed above, advocates of ICES can implement ICES in forms which will be least affected by regulatory impediments in order to establish showcase ICES designed to demonstrate the viability and special benefits of the ICES concept. After these showcase ICES have existed in peaceful coexistence with conventional utilities for a time, conventional utilities, utility regulators and legislators may be more amenable to the type of system modifications necessary to encourage widespread implementation of ICES in many forms. At this point, the advocates of an ICES might effectively petition PUCs and state legislatures to define certain categories of ICES which will be exempt from certain troublesome aspects of the traditional regulatory system while enjoying some of its benefits.

In order to qualify as an Exempt-ICES, the ICES must, of course, be required to establish that it would be a reliable, responsible supplier of energy. Once utility regulators are convinced that the ICES has the financial and technological ability to adequately serve its proposed customers, the ICES could be exempted from many traditional areas of regulation without jeopardizing the best interest of the customers.

The Exempt-ICES should be permitted to commence operations to appropriate groups of customers in the service areas of conventional utilities. However, like the ICES-Co-Op, it should be required to purchase any equipment owned by the conventional utility which is rendered useless as a result of

the ICES being permitted to serve customers within the conventional utility's service area. Once it has established its service area, the Exempt-ICES should receive the type of territorial protection traditionally afforded public utilities.

The Exempt-ICES could also be freed from traditional PUC rate regulation. Rather than establishing traditional cost-based rates, the Exempt-ICES could be permitted to market its energy package at any rate which does not exceed the rates for comparable service from conventional utilities. If the Exempt-ICES believed that it was, for some reason, entitled to higher rates, it should be compelled to submit to traditional rate-making procedures. This should assure that, if the ICES concept is in fact economically viable, investors will be able to achieve sufficient returns on their investment while ICES customers are guaranteed reliable energy service at reasonable rates.