ALAN WILSON
ATTORNEY GENERAL

May 2, 2018

The Honorable Peter M. McCoy Jr., Member
South Carolina House of Representatives
District No. 115
420D Blatt Building
Columbia, SC 29201

The Honorable Kirkman Finlay III, Member
South Carolina House of Representatives
District No. 75
532A Blatt Building
Columbia, SC 29201

The Honorable J. Todd Rutherford, Member
South Carolina House of Representatives
District No. 74
335B Blatt Building
Columbia, SC 29201

Dear Representatives McCoy, Finlay and Rutherford:

The House version of S. 954 is currently a part of conference committee negotiations between the House and Senate. Our understanding is that the Bill sets an "experimental rate" for ratepayers under the BLRA at "0," pending a review by the Public Service Commission ("PSC") which would allow the PSC to "balance" rates in a general rate proceeding under the traditional standards of "Bluefield Hope" and the Southern Bell case.[1] Specifically, you ask whether "removal of all revised rate increases imposed pursuant to the BLRA on a prospective and interim basis, while vesting the PSC with continued authority to monitor and adjust the rate, complies with the applicable constitutional balancing test until such time as the proposed Dominion/SCANA merger petition is resolved by the PSC." As stated, and without attempting to take sides in any House-Senate negotiations, we believe a court would conclude the answer is "yes."

[1] See Bluefield Water Works & Improvement Co. v. Public Service Comm'n of West Virginia, 262 U.S. 679, 43 S.Ct. 675 (1923); Fed. Power Comm'n v. Hope Nat. Gas Co., 320 U.S. 591, 64 S. Ct. 281 (1944); and S. Bell Tel. & Tel. Co. v. Pub. Serv. Comm'n, 270 S.C. 590, 244 S.E.2d 278 (1978), holding modified by Parker v. S.C. Pub. Serv. Comm'n, 280 S.C. 310, 313 S.E.2d 290 (1984). In Hope, the United States Supreme Court stated: "[t]he ratemaking process under the Act, i.e. the fixing of just and reasonable rates, involves the balancing of the investor and consumer interests." 270 U.S. at 596. In Southern Bell, our Supreme Court recognized that "[t]he two leading cases from the United States Supreme Court setting forth the basic principles of utility rate regulation are" Hope and Bluefield.

Law/Analysis

In Op. S.C. Attorney General, 2017 WL 4464415 (September 26, 2017), we addressed the constitutionality of the BLRA (Act No. 16 of 2007). In that Opinion, we concluded that many portions of the BLRA are "constitutionally suspect." That question is currently the subject of litigation in which the State is a party and is represented by the Attorney General's Office. In that litigation, we continue to assert the BLRA is unconstitutional. Of course, we are unable to make any comment herein about the constitutionality of the BLRA or that litigation.

The BLRA is also being addressed legislatively. The House version of S. 954 represents the efforts of the House of Representatives to do just that. As noted above, the House version of S. 954 adopts an experimental rate of "0" for those additional rates assessed SCE&G ratepayers under the BLRA, subject to review by the PSC under traditional ratemaking standards. Such an experimental rate amounts to an 18% reduction in BLRA imposed rates.[2] Such traditional standards would be as stated earlier, those used in Bluefield-Hope and Southern Bell. As noted, Hope in particular requires a "balancing" of interests between the utility and its investors on one hand, and consumers on the other. See also Mims v. Edgefield Co. Water and Sewer Authority, 278 S.C. 554, 556, 299 S.E.2d 484, 486 (1983) ["The reasonableness of rates should be determined by an evaluation of the utility's holdings and obligations and the return which the utility realizes from the rates. (citing Southern Bell). The focus is upon the financial conditions of the utility, particularly whether the return realized from the rates is so low as to be confiscatory to the utility or so high as to be unduly burdensome to the utility's customers."].

Our September 26 Opinion, discussed at some length the United States Supreme Court decision of Duquesne Light Co. v. Barasch, 488 U.S. 299 (1989). We believe Duquesne governs your question. In Duquesne, the Court addressed the question of whether an amendment by the Pennsylvania Legislature, while a rate proceeding was ongoing, constituted a "taking" without just compensation under the federal Constitution. As we advised in the opinion,

> [t]he Court held that the Pennsylvania law, as amended, met the requirements of Hope Natural Gas as not confiscatory, even though it was retroactively applied by the Pennsylvania Legislature. Duquesne emphasized that "[i]t cannot seriously be contended that the Constitution prevents state legislatures from giving specific instructions to their utility commissions. We have never doubted that state legislatures are competent bodies to set utility rates." Id. at 313. Moreover, the rate set by the amended law was "just" and "reasonable" under Hope even though Pennsylvania retroactively excluded CAPCO costs by eliminating any project not used and useful.

[2] The Senate, as we understand it, has adopted what amounts to an experimental rate with respect to BLRA imposed rates of a 13% rate reduction.

Moreover, in Duquesne, the Supreme Court also emphasized that "[t]he Constitution within broad limits leaves the States free to decide what rate setting methodology best meets their needs in balancing the interests of the utility and the public." 488 U.S. at 316. In other words, if the Legislature, as the ultimate ratemaking authority in South Carolina (see Art. IX, § 1 of the South Carolina Constitution),[3] determines that a particular rate "balance" is best, the Supreme Court and other courts will afford such a balancing decision great weight.

Also, in Duquesne, it is crucial to note that the Supreme Court examined the Pennsylvania amendments' impact upon the entire system of the utility, not just upon the nuclear portion of the utility's structure:

> Pennsylvania determines rates under a slightly modified form of the historical cost/prudent investment system. Neither Duquesne nor Penn Power alleges that the total effect of the rate order arrived at within this system is unjust or unreasonable. In fact the overall effect is well within the bounds of Hope, even with total exclusion of the CAPCO costs. Duquesne was authorized to earn a 16.14% return on common equity and an 11.64% overall return on a rate base of nearly $I.8 billion. See Pennsylvania PUC v. Duquesne Light Co., 57 Pa. P.U.C., at 51, 51 P.U.R. 4th, at 243. Its $35 million investment in the canceled plants comprises roughly 1.9% of its total base. The denial of plant amortization will reduce its annual allowance by 0.4%. Similarly. Penn Power was allowed a charge of 15.72% return on common equity and a 12.02% overall return. Its investment in the CAPCO plants comprises only 2.4% of its $401.8 million rate base. See Pennsylvania PUC v. Pennsylvania Power Co., 58 Pa. P.U.C., at 331-332, 60 P.U.R. 4lh. at 618. The denial of amortized recovery of its $9.6 million investment in CAPCO will reduce its annual revenue allowance by only 0.5%.

488 U.S. at 310-311 (emphasis added).

Accordingly, Duquesne stressed that even a total retroactive "roll back" of CAPCO costs in the nuclear rate, when viewed in the context of the utility's overall structure, was constitutional.

The Senate recently commissioned a report, which is known as the "Bates-White" Report, and which has closely examined the financial ability of SCE&G/SCANA to absorb reductions in or removal of rates garnered from the BLRA. The Bates-White Report concluded that a 13% interim rate reduction in BLRA imposed rates "can be absorbed by SCE&G and SCANA without significantly increasing the likelihood of insolvency. This reduction could be achieved entirely through a reduction in SCE&G's dividend payment, and thus sets the minimum rate reduction." Report at 12 (emphasis added). According to the Report,

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[3] Art. IX, § 1 of the South Carolina Constitution provides, in pertinent part, that "[t]he General Assembly shall provide for appropriate regulation of . . . privately owned utilities serving the public as and to the extent required by the public interest."

> [i]n the event that an interim reduction of 18% equal to 445 million revenue reduction required an impairment of equal magnitude, capitalization (through equity) would be reduced by 278 million after taxes. This reduction in equity would increase the debt to capitalization ratio by on 1.4%, from 53.0% to 54.4%. . . .

Report at 39. An 18% interim reduction or a "0" rate is, as we understand it, what the House version of S. 954 proposes. Our reading of Duquesne is that such a financial impact would likely be deemed constitutional.

Conclusion

Without attempting to take sides in any House-Senate negotiations, our opinion is that a court would likely conclude that the House version of S. 954, if enacted, is constitutional under Duquesne and is not confiscatory. Only a court could determine otherwise, however.

As the United States Supreme Court stated in Duquesne, "[t]he Constitution within broad limits leaves the States free to decide what rate setting methodology best meets their needs in balancing the interests of the utility and the public." We note here that the House version of S. 954 was proposed after SCE&G abandoned this construction project. Thus, the project will never become "used and useful" to ratepayers as that term is commonly understood.

Duquesne also concluded that any "takings" argument must be evaluated in the context of the impact of a legislatively imposed rate reduction upon the utility's entire business, not just upon its nuclear portion. Indeed, the Supreme Court noted that ". . . the overall effect is well within the bounds of Hope even with total exclusion of the CAPCO costs." 488 U.S. at 311. Likewise, the Bates White Report concludes that an interim reduction of 18% would result in a "reduction in equity [which] would increase the debt to capitalization ratio by only 1.4% from 53.0% to 54.4%." Report at 39.

In summary, given the great leeway which Duquesne recognizes that state legislatures are afforded "to decide what rate setting methodology best meets the needs in balancing the interests of the utility and the public," we believe a court would conclude that the House version of S. 954 is constitutional.[4] As the Supreme Court stated in Duquesne, "[t]he Constitution is not designed to arbitrate . . . economic niceties" 488 U.S. at 314.

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[4] It appears this situation is far closer to, if not virtually identical with, Duquesne, as opposed to Jersey Cen. Power & Light Co. v. F.E.R.C., 810 F.2d 1168, 1178 (D.C. Cir. 1987). In a far worse situation in Jersey Central, in terms of the financial condition of the utility, the D.C. Circuit concluded that, only after a factual hearing, could there be a determination of whether the Hope balance had been violated, such that there was either a confiscatory taking, of the utility's property or an exploitation of consumers.

Of course, we again emphasize that we express no opinion as to any ongoing efforts between the House and Senate conferees to resolve which rate reduction proposal (House or Senate version) best suits the State's needs. Such a determination must, of course, be answered by the General Assembly. As the Court explained in Duquesne, "[w]e have never doubted that state legislatures are competent bodies to set utility rates."

Sincerely,

Robert D. Cook
Solicitor General