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# Bangor Gas: An Analysis of the Law Court's Decision in *Office of the Public Advocate v. Public Utilities Commission*

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# BANGOR GAS: AN ANALYSIS OF THE LAW COURT'S DECISION IN *OFFICE OF THE PUBLIC ADVOCATE V. PUBLIC UTILITIES COMMISSION*

*Taylor Talmage*

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## BANGOR GAS: AN ANALYSIS OF THE LAW COURT'S DECISION IN *OFFICE OF THE PUBLIC ADVOCATE V. PUBLIC UTILITIES COMMISSION*

Taylor Talmage\*

### I. INTRODUCTION

With a turn of the thermostat, your gas furnace fires up to provide heat on a cold winter night. With the flick of a switch, the lights come on in your home. Both of these actions are common everyday occurrences, and both rely on regulated public utilities to supply the energy necessary to achieve the desired ends. For a vast majority of Mainers hardly any thought is likely given to these actions or the complicated regulatory framework that allows this energy to reach their homes. Yet energy use, as well as the accompanying body of law and policy that regulates energy utilities, pervades all aspects of modern society. Not only does energy power our consumer products and heat our homes, it also powers the industrial and commercial businesses that provide jobs and generate growth in our economy. In fact, as commentators have long noted, complex modern societies, such as ours, are completely dependent upon utility service.<sup>1</sup> This dependence is only strengthened as technological advancements continue and critical sectors of society, such as banking and finance, become ever more reliant on technology. Thus, as our dependence increases and energy plays an ever more important role in our society, it becomes progressively more important that the legal framework regulating energy utilities serves the public interest.<sup>2</sup>

In Maine, the Public Utilities Commission (the “Commission” or “PUC”) was first established in 1913.<sup>3</sup> The basic purpose of the Commission is “to ensure safe, reasonable and adequate service, to assist in minimizing the cost of energy

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1. MARTIN T. FARRIS & ROY J. SAMPSON, PUBLIC UTILITIES 4 (1973).

2. The intersection of utility law and policy in Maine has received much attention by both the public and the Governor in recent years. See, e.g., Scott Thistle, *LePage Continues Effort to Lower Energy Costs for Maine Ratepayers*, BANGOR DAILY NEWS, Jan. 5, 2014, <http://bangordailynews.com/2014/01/05/politics/lepage-continues-effort-to-lower-energy-costs-for-maine-ratepayers/>; Tux Turkel, *PUC staff: Maine Electricity Ratepayers Shouldn't be Charged for Natural Gas Pipeline Expansion*, PORTLAND PRESS HERALD, Oct. 1, 2014, <http://www.pressherald.com/2014/10/01/puc-staff-maine-electric-ratepayers-shouldnt-be-charged-to-secure-natural-gas-delivery-contracts/>. Policy was specifically cited by the Public Utilities Commission as one factor guiding their decision in the order that gave rise to case on which this Note focuses. Bangor Gas Co., LLC, Request for Approval of Renewal of Multi-Year Rate Plan (35-A.M.R.S. § 4706), No. 2012-00598, Order at 8-9 (Me. P.U.C. 2014) (“[A] key factor underlying the design of the prior rate plans, that being to encourage the expansion of natural gas service in Maine, remains an important policy goal today.”).

3. P.L. 1913 ch. 129 §§ 1, 10.

available to the State's consumers and to ensure that the rates of public utilities subject to rate regulation are just and reasonable to customers and public utilities."<sup>4</sup> The purpose of the requirement that rates must be "just and reasonable" is to ensure that a natural monopoly, such as an energy utility, sets its prices in a manner which allows it to meet all reasonable demand for its services.<sup>5</sup> While regulatory bodies are given discretion in determining what constitutes a "just and reasonable" rate, they do not act wholly without guidelines set by the Legislature.<sup>6</sup> Specifically, the Legislature has set guidelines that the Commission must follow when determining the value of utility property for the purpose of setting rates that will allow the utility to recover its investment in that property.<sup>7</sup> These guidelines, as set forth in title 35-A, section 303 of the Maine Revised Statutes, are the focus of this Case Note.

This Note will examine a recent case, *Office of the Public Advocate v. Public Utilities Commission*, in which the Maine Supreme Judicial Court, sitting as the Law Court, affirmed a decision of the Commission granting Bangor Natural Gas Co.'s ("Bangor Gas") request to renew its alternative rate plan.<sup>8</sup> This Note argues that the Law Court erred when it affirmed the Commission's order setting an alternative rate plan for Bangor Gas. In setting the alternative rate plan the Commission adopted a value of Bangor Gas's property that was based upon the \$38 million invested into the company by Bangor Gas's former owner, Sempra, and not the \$500,000 that Bangor Gas's current owner, Energy West Inc., paid to acquire the company in 2007.<sup>9</sup> By only using the larger value the Commission abused its discretion when it assigned no weight to the \$500,000 acquisition cost. Although the Commission can be said to have "considered" the acquisition cost, the Commission did not give it the "due consideration" required by statute and thus failed to follow the mandate of the Legislature. This Note argues that, by holding that the decision was properly made within the discretion of the PUC, the Law Court did more than just affirm a decision of the Commission that was made contrary to the law. More notably, through that affirmance, the Law Court permitted Energy West to obtain a return on a \$38 million dollar investment that the

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4. 35-A M.R.S.A. § 101 (2010 & Supp. 2015).

5. DAVID C. HJELMFELT, *ANTITRUST AND REGULATED INDUSTRIES* 134 (1985).

6. *City of Biddeford by Bd. of Ed. v. Biddeford Teachers Ass'n*, 304 A.2d 387, 398 (1973) ("[I]t is well established that a legislative body cannot delegate the legislative power without including in the delegating statute sufficient standards to guide the agents in the exercise of the legislative authority."); *Uliano v. Bd. of Envtl. Prot.*, 2009 ME 89, ¶ 15, 977 A.2d 400 ("[L]egislation delegating discretionary authority to an administrative agency is unconstitutional if it fails to 'contain standards sufficient to guide administrative action.'") (quoting *Lewis v. Dep't of Human Servs.*, 433 A.2d 743, 747 (Me. 1981)).

7. Title 35-A of the Maine Revised Statutes provides the statutory backbone of the PUC's administrative authority. The focus of this Note will be on section 303, which governs the valuation of property for the purposes of fixing rates charged by regulated utilities. 35-A M.R.S.A. § 303 (2010 & Supp. 2015).

8. *Office of the Pub. Advocate v. Pub. Utils. Comm'n*, 2015 ME 113, 122 A.3d 959 [hereinafter *Bangor Gas*]; see also *Bangor Gas Co., LLC, Request for Approval of Renewal of Multi-Year Rate Plan* (35-A M.R.S. § 4706), No. 2012-00598, Order (Me. P.U.C. 2014).

9. *Bangor Gas Co., LLC, Request for Approval of Renewal of Multi-Year Rate Plan* (35-A M.R.S. § 4706), No. 2012-00598, Order at 14-15 (Me. P.U.C. 2014) 112007.

company did not make and for which the company did not bear the risk of loss.<sup>10</sup> In doing so, the Law Court violated a fundamental principle of utility law: investors are only entitled to a return on investments they have actually made.<sup>11</sup>

Part II of this Note discusses the evolution of laws concerning the valuation of property to be included in rate base and the formulation of the fundamental principle that investors are only entitled to a return on their investments actually made. Part III provides the factual background and holding of the Law Court's opinion in *Bangor Gas*. Finally, Part IV analyzes the Law Court's opinion,<sup>12</sup> focusing particularly on the court's failure to discuss the fundamental principle that investors are entitled to a return only on investments they have actually made; why this discussion may have been absent from the opinion; why, despite this absence, the court still committed error in affirming its decision; and a brief examination of the court's response to the Public Advocate's argument that the Commission used an unlawful factor—the current value of Bangor Gas's assets—in its decision.<sup>13</sup>

## II. A HISTORY OF THE VALUATION OF PROPERTY INCLUDED IN RATE BASE

One of the principle obligations of a utility regulator is to ensure that rates charged by public utilities are “just and reasonable” to consumers and allow for a “fair return” for investors on the capital invested in the utility.<sup>14</sup> In assessing what constitutes a reasonable or fair rate, commentators have noted that there are three major steps in making a determination. The first step is to determine what constitutes the value of the utilities property.<sup>15</sup> This is known as the utility's “rate base.”<sup>16</sup> Second, one must determine what constitutes the utility's return.<sup>17</sup> Third, based on the first two factors, the regulator must finally determine what the utility should be allowed to earn on its property investment.<sup>18</sup> While factors two and three are undoubtedly worthy of discussion, it is only the first of these three, the value of the utility's rate base, that is the focus of this Note. What follows in this Section will be a discussion of the various methods that have been used to determine the value of a utility's rate base and the current methodology that the Legislature has established for making this determination in Maine.

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10. Not only does Energy West not bear the risk of losing the \$38 million invested by Sempra, but this loss was already realized by Sempra when it sold Bangor Gas to Energy West for \$500,000. “[I]n 2006, Sempra recognized an impairment loss which reduced its net book value to \$0.” See *id.* at 11.

11. See *Me. Water Co. v. Pub. Utils. Comm'n*, 388 A.2d 493 (Me. 1978); *Rangeley Water Co. v. Rangeley Water Dist.*, 1997 ME 32, 691 A.2d 171; *infra* text accompanying notes 46-52.

12. In its decision the Law Court also addressed the OPA's argument that the commission abused its discretion by including a portion of Bangor Gas's regulatory proceeding expenses in its revenue requirement calculation. *Bangor Gas*, 2015 ME 113, ¶¶ 23-25, 122 A.3d 959. This second contention by the OPA will not be addressed in this Note, however.

13. See *Bangor Gas*, 2015 ME 113, ¶ 22, 122 A.3d 959. In total the Court devotes one paragraph of its opinion to discussing the OPA's argument that the PUC unlawfully used the current value of the Bangor Gas property when determining the value of the property included in rate base.

14. CHARLES F. PHILLIPS, *THE REGULATION OF PUBLIC UTILITIES* 281 (1984).

15. FARRIS & SAMPSON, *supra* note 1, at 80.

16. *Id.*

17. *Id.*

18. *Id.*

### A. *The Fair Value Doctrine*

In 1898, the United States Supreme Court, in *Smyth v. Ames*,<sup>19</sup> enunciated what became known as the “fair value doctrine” of rate base valuation.<sup>20</sup> In *Smyth*, the Court held that “the basis of all calculations as to the reasonableness of rates must be the fair value of the property being used by it for the convenience of the public.”<sup>21</sup> The Court enumerated six factors that should be considered in determining this “fair value.”<sup>22</sup> Among these were: “the original cost of construction and the cost of permanent improvements” and “the present as compared with the original cost of construction.”<sup>23</sup> While this may seem fairly straightforward, in the years following *Smyth*, regulatory bodies and the courts tasked with reviewing the decisions of those bodies frequently struggled to employ the Court’s guidance.<sup>24</sup> This confusion was due, in part, to the Court’s instruction that each measure must be given “such weight as may be just and right.”<sup>25</sup> However, beginning in the 1930s and culminating in the Court’s 1944 decision in *Federal Power Commission v. Hope Natural Gas*,<sup>26</sup> the Court shifted its emphasis away from requiring adherence to the imprecise “fair value method.”<sup>27</sup>

### B. *Hope Natural Gas*

In *Hope*, the Court reversed the United States Court of Appeals for the Fourth Circuit after it set aside a Federal Power Commission order that decreased a company’s wholesale gas rates by more than sixty percent.<sup>28</sup> The Court of Appeals based its decision on the fact that because “the rate base should reflect the ‘present fair value’ of the property . . . the Commission . . . should have considered the reproduction cost and trended original cost” of the property.<sup>29</sup> Additionally the Fourth Circuit held that the “actual legitimate cost . . . was not the proper measure of fair value.”<sup>30</sup>

In its decision, the Supreme Court followed its precedent in *Federal Power Commission v. Natural Gas Pipeline Co.*,<sup>31</sup> and held that “[u]nder the statutory standard of ‘just and reasonable,’ it is the result reached, not the method employed, which is controlling.”<sup>32</sup> Thus, federal courts and administrative agencies were no

19. 169 U.S. 466, 546 (1898).

20. PHILLIPS, *supra* note 14, at 286 (explaining that Justice Harlan’s opinion would go on to become “the legal basis of the ‘fair value’ doctrine”).

21. *Smyth*, 169 U.S. at 546.

22. *Id.* at 546-47.

23. *Id.*

24. PHILLIPS, *supra* note 14, at 287.

25. *Smyth*, 169 U.S. at 547.

26. 320 U.S. 591 (1944).

27. PHILLIPS, *supra* note 14, at 297 (describing the *Hope* decision as resulting in a shift of focus away from rate base, and the determination of what constitutes its fair value, to the rate of return a utility is allowed on its rate base).

28. *Hope*, 320 U.S. 591; PHILLIPS, *supra* note 14, at 295-96.

29. *Hope*, 320 U.S. at 599-600.

30. *Id.* at 600 (internal quotation marks omitted). In its holding, the court treated “actual legitimate cost” as being equivalent to “prudent investment.” *See id.*

31. 315 U.S. 575 (1942).

32. *Hope*, 320 U.S. at 602.

longer bound by the “fair value doctrine” in determining the rate base of a utility. This decision was not wholly without guidance. The Court pointed out that it would be important to investors that rate-setting allow enough revenue to cover both the operating expenses and the capital costs of the business.<sup>33</sup> Therefore, an investor’s return on investment should be “commensurate with returns on investments in other enterprises having corresponding risks.”<sup>34</sup> Accordingly, the Court noted that “[r]ates which enable [a] company to operate successfully, to maintain its financial integrity, to attract capital, and to *compensate its investors for the risks assumed* certainly cannot be condemned as invalid.”<sup>35</sup>

Thus, *Hope* gives substantial leeway to administrative agencies when setting rates, but it also indirectly outlines a fundamental principle of utility law: investors are entitled to a return only on their actual investments. No longer would the precise method of valuation be the ultimate determinant of whether rates are “just and reasonable.”<sup>36</sup> Instead, courts are required to look at the end result of the rate-making process.<sup>37</sup> Rates are just and reasonable so long as they assure confidence in the financial integrity of the company, allow the company to maintain its credit and attract capital, and allow investors a return on their investments commensurate with the risk of those investments.<sup>38</sup>

### C. *The Fundamental Principle in Maine*

#### 1. *The Legislature*

In Maine, the fair value doctrine persisted until 1957, when the Legislature passed Legislative Document 249.<sup>39</sup> This bill required that when the Commission determines the valuation of property for ratemaking purposes, “the reasonable value upon all property of any public utility used or required to be used in its service to the public within the state . . . [would be] established by the net prudent investment, and a fair return thereon.”<sup>40</sup> In the same year, the Legislature further revised the rate making process by requiring that, “[i]n determining just and reasonable rates, the Commission shall provide such revenues to the utility as may be required to perform its public service and to attract necessary capital on just and reasonable terms.”<sup>41</sup> Additionally, the Legislature not only struck the “current value” of the property from the list of factors to consider when determining the value of a utility’s rate base, but expressly prohibited its consideration.<sup>42</sup>

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33. *Id.* at 603.

34. *Id.*

35. *Id.* at 605 (emphasis added).

36. *Hope*, 320 U.S. at 602.

37. *Id.* at 602; *see also* Cent. Me. Power Co. v. Pub. Utils. Comm’n, 455 A.2d 34, 39 (Me. 1983) (citing *Hope* for the proposition that “since this Court’s review is limited to the ‘result reached and not the method employed,’ it should not disturb the Commission’s result so long as [that result] is within a range of reasonableness supported by sufficient evidence”) (emphasis omitted).

38. *Hope*, 320 U.S. at 603.

39. L.D. 249 (98th Legis. 1957).

40. *Id.* § 18.

41. L.D. 1595, § 17 (98th Legis. 1957).

42. L.D. 1595, § 2 (98th Legis. 1957).

Thus, in 1957 the Legislature enacted as statute the Supreme Court's holding from *Hope*.<sup>43</sup> By affirming that prudent acquisition cost is probative of the value of the property on which investors earn a "fair return," and by stating that rates are "just and reasonable" when they allow a public utility to perform its public service and attract capital, the Legislature acknowledged that it is the investments actually made by investors upon which they are entitled to a return.<sup>44</sup> While this acknowledgment may only be implicit in the statutory language, it is worthy to note that during House debates concerning the passage of Legislative Document 249, a House member of the Committee on Public Utilities expressly stated that the intent of the bill was that "there should be a full recognition of all costs incurred in investments actually made. No return on costs not incurred or on investments not actually made."<sup>45</sup> Even discounting this as one statement by one member of the Legislature, and thus not representative of the body as a whole, this principle has also been recognized by the Law Court.<sup>46</sup>

## 2. *The Law Court*

While the Law Court acknowledged the codification of its reasoning from *Hope* in its 1978 decision in *New England Telephone and Telegraph Co. v. Public Utilities Commission*,<sup>47</sup> this principle has been most prominent in cases involving contributed property. In *Maine Water Co. v. Public Utilities Commission*, the court disallowed Maine Water Company from recovering depreciation on contributed property as the company had not made the initial investment in the property, and therefore had no investment to recover through depreciation.<sup>48</sup> Similarly, in *Rangeley Water Co. v. Rangeley Water District*, the court emphasized that depreciation on contributed property was disallowed not because it would be credited to those who contributed the property, but "to insure that investors who did not supply capital for the contributed property do not recover on an 'investment' they did not make."<sup>49</sup> In *Rangeley Water Co.*, the court went further and explicitly stated the Commission "will not permit utilities to recover . . . the depreciation on contributed property because the utility did not make the original investment in contributed property."<sup>50</sup> Thus, *Rangeley Water Co.* represents a significant development in that the court gave very precise instructions to the Commission that investors will not be able to recover, through depreciation, an investment that they did not make.

While this line of cases is distinguishable from *Bangor Gas* in that they involve contributed property—whereas *Bangor Gas* involves the purchase of utility property sold at a loss by its prior investors—the underlying rationale is just as

43. L.D. 249 (98th Legis. 1957); L.D. 1595 (98th Legis. 1957).

44. L.D. 1595, §§ 2, 17 (98th Legis. 1957).

45. 1 Legis. Rec. 1407 (1957).

46. See *Me. Water Co. v. Pub. Utils. Comm'n*, 388 A.2d 493 (Me. 1978); *Rangeley Water Co. v. Rangeley Water Dist.*, 1997 ME 32, 691 A.2d 171; *infra* text accompanying notes 46-53.

47. *New England Tel. and Tel. Co. v. Pub. Utils. Comm'n*, 390 A.2d 8, 14 (Me. 1978).

48. *Me. Water Co. v. Pub. Utils. Comm'n*, 388 A.2d 493, 495 (Me. 1978).

49. *Rangeley Water Co.*, 691 A.2d at 178 (Me. 1997) (quoting *Cent. Me. Power Co. v. Pub. Utils. Comm'n*, 405 A.2d 153, 166-67 (Me. 1979)).

50. *Id.*

pertinent. In both of these cases the court's disallowance of depreciation is based on the fact that the investors had not made the original investment in the contributed property.<sup>51</sup> This disallowance was not made because the specific mechanism used, depreciation, made it impossible for the investors to recover on such a non-investment.<sup>52</sup> Similarly, the fact that it is contributed property in these cases makes no difference because nowhere does the court premise its holdings on the specific type or conveyance of the property as being a reason for disallowing the deduction. Instead, the court reasons very precisely that investors are not permitted to recover their non-investment because those investors "*did not make the original investment* in the contributed property."<sup>53</sup>

### III. OFFICE OF THE PUBLIC ADVOCATE V. PUBLIC UTILITIES COMMISSION

#### A. Factual Background

Bangor Gas is a natural gas local distribution company that provides gas service to approximately 4,000 residential, commercial, and industrial customers in the greater Bangor area.<sup>54</sup> Bangor Gas began providing service to customers in 1998 as a startup gas utility of its parent company Penobscot Natural Gas ("Penobscot").<sup>55</sup> At that time both Bangor Gas and Penobscot were owned by Sempra Energy LLC.<sup>56</sup> Because of the large front-end expenses associated with being a startup utility, the Public Utilities Commission approved Bangor Gas's alternative rate plan ("ARP") for a period of ten years.<sup>57</sup> During this time Sempra Energy made substantial capital investments in Bangor Gas's service infrastructure.<sup>58</sup> Despite these investments, Bangor Gas was not profitable, and in 2006, Sempra Energy sought to sell the company.<sup>59</sup>

In December of 2006, Energy West offered to acquire Bangor Gas by purchasing Penobscot's stock for \$500,000.<sup>60</sup> Due in part to both the pending sale and the lack of profitability, Sempra performed an impairment analysis of Bangor Gas's assets after which it determined that the fair market value of those assets was

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51. *Id.* ("In a rate proceeding contributed property is not included in a utility's rate base because it would be unfair to allow the utility's investors to recoup from ratepayers money that the utility did not expend."); see also *Me. Water Co.*, 388 A.2d at 495 ("[T]he aim of depreciation . . . is to permit a utility to recover its original investment in the property.").

52. See *Rangeley Water Co.*, 691 A.2d at 178 (distinguishing the valuation of contributed property for the purposes of ratemaking from the valuation of contributed property for the purpose of determining just compensation owed when property has been condemned under the exercise of eminent domain); see also *Cent. Me. Power Co. v. Pub. Utils. Comm'n.*, 405 A.2d 153, 166-67 (Me. 1979) ("Depreciation on contributed property is therefore disallowed not to credit the donees, but to insure that investors who did not supply capital for the contributed property do not recover on an 'investment' they did not make.").

53. *Me. Water Co.*, 388 A.2d at 495 (emphasis added).

54. *Bangor Gas*, 2015 ME 113, ¶ 3, 122 A.3d 959.

55. *Id.*

56. *Id.*

57. *Id.*

58. *Id.* ¶ 4.

59. *Id.*

60. *Id.* ¶ 5.

\$500,000.<sup>61</sup> The impairment analysis resulted in Bangor Gas's assets being written down to zero and Sempra recording an accounting loss of \$38 million.<sup>62</sup> With Commission approval, the sale was finalized in 2007 and, through this purchase, Energy West thus invested \$500,000 in Bangor Gas compared to the \$38 million invested and subsequently written down by Sempra.<sup>63</sup> In November 2007, Bangor Gas's ARP was extended for three years.<sup>64</sup> Following the sale, Bangor Gas connected and put into service several sections of pipeline that were not in service when Sempra owned the company.<sup>65</sup>

In December 2012, Bangor Gas filed a petition to renew its ARP for another ten-year period.<sup>66</sup> Following the filing of this petition the Office of the Public Advocate filed a petition to intervene, which the Commission granted.<sup>67</sup> Pursuant to title 35-A, section 4706(3) of the Maine Revised Statutes, and in order to evaluate the reasonableness of the proposed ARP, the Commission conducted a traditional rate-setting cost-of-service and revenue requirement analysis.<sup>68</sup> Following this analysis, the Commission authorized Bangor Gas's ARP for a term of seven years.<sup>69</sup> This authorization contained no change in rates.<sup>70</sup> Subsequently, the OPA and Bucksport Mill appealed from the Commission's order arguing that the Commission exceeded its statutory authority when it valued Bangor Gas's assets based upon Sempra's investment of \$38 million instead of the \$500,000 that Energy West paid to acquire the company.<sup>71</sup>

### B. *The Law Court's Decision*

The Law Court gives deference to Commission decisions and will only overturn a decision when the Commission "abuses the discretion entrusted to it or fails to follow the mandate of the legislature . . . ."<sup>72</sup> Moreover, the court will only review questions of law and will not second guess the Commission's fact finding.<sup>73</sup>

In its analysis of the Commission's decision, the Law Court first examined title 35-A, section 303 of the Maine Revised Statutes, which provides that:

In determining just and reasonable rates, tolls and charges, the commission shall fix a reasonable value upon all the property of a public utility . . . which is used or required to be used in its service to the public within the State and a fair return on that property. In fixing a reasonable value, the commission shall *give due consideration* to evidence of the *cost of the property when first devoted to public*

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61. *Id.*

62. *Id.*; Bangor Gas Co., LLC, Request for Approval of Renewal of Multi-Year Rate Plan (35-A M.R.S. § 4706), No. 2012-00598, Order at 11 (Me. P.U.C. 2014).

63. *Bangor Gas*, 2015 ME 113, ¶¶ 5-6, 122 A.3d 959.

64. *Id.* ¶ 6.

65. *Id.* ¶ 7.

66. *Id.* ¶ 8.

67. *Id.*

68. *Id.* ¶ 10.

69. *Id.*

70. *Id.*

71. *Id.* ¶¶ 13-14.

72. *Id.* ¶ 15 (quoting *Houlton Water Co. v. Pub. Utils. Comm'n*, 2014 ME 38, ¶ 24, 87 A.3d 749).

73. *Bangor Gas*, 2015 ME 113, ¶ 15, 122 A.3d 959; *New England Tel. and Tel. Co. v. Pub. Utils. Comm'n*, 390 A.2d 8, 15 (Me. 1978).

*use and the prudent acquisition cost to the utility, less depreciation on each, and any other material and relevant factors or evidence, but the other factors shall not include current value.* In making a valuation, the commission may consult reports, records or other information available to it in the office of any state office or board.<sup>74</sup>

In giving “due consideration” to these factors, the Law Court stated that the Commission has “broad discretion” to consider any “relevant or material” factor except for “current value”<sup>75</sup> and that the Commission need not give equal weight to each factor.<sup>76</sup> However, due consideration requires that each factor receive “reasonable and fair consideration,” and must be reflected in the finding of value.<sup>77</sup>

In applying these standards in *Bangor Gas*, the Law Court found that the Commission gave the requisite due consideration to both Energy West’s acquisition cost as well as the original cost of the property when Sempra first put it to public use.<sup>78</sup> Furthermore, the court held that the Commission’s rejection of Energy West’s acquisition cost, \$500,000, and acceptance of Sempra’s original cost, \$38 million, as being more probative of the value of the property was entirely consistent with the Commission’s statutory authority.<sup>79</sup> Moreover, these considerations were carefully made out of concerns for the productivity of the company, its ability to attract capital and provide a fair return to investors, and rate stability.<sup>80</sup>

In responding to the OPA’s contention that the Commission had unlawfully used the “current value” or “fair market value” of the property to arrive at its decision, the Law Court stated that the Commission acted consistently with its “statutory mandate” when it made its determination of “reasonable value” by determining what value “would allow the utility to realize a fair return on equity *in light of its current operations and service capacity.*”<sup>81</sup> After giving due consideration to all statutory factors, the Law Court found that the Commission had appropriately determined that the “original cost valuation more accurately reflected the reasonable value of the property” on which the company was entitled to a return.<sup>82</sup> Thus, the Commission did not abuse its discretion or exceed its statutory authority when it determined that, for the purposes of determining rate-base, the \$38 million invested by Sempra, and not the \$500,000 paid by Energy West’s investors to acquire the company, more accurately reflected the value of Bangor Gas’s property.<sup>83</sup>

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74. 35-A M.R.S.A § 303 (2010 & Supp. 2015).

75. *Bangor Gas*, 2015 ME 113, ¶ 18, 122 A.3d 959.

76. *Id.* ¶ 19; Cent. Me. Power Co. v. Pub. Utils. Comm’n, 150 Me. 257, 262, 109 A.2d 512, 514 (1954).

77. *Bangor Gas*, 2015 ME 113, ¶ 19, 122 A.3d 959; Cent. Me. Power Co. v. Pub. Utils. Comm’n, 150 Me. 257, 262, 109 A.2d 512, 514 (1954).

78. *Bangor Gas*, 2015 ME 113, ¶ 21, 122 A.3d 959.

79. *Id.*

80. *Id.*

81. *Id.* ¶ 22 (emphasis added).

82. *Id.*

83. *Id.*

## IV. ANALYSIS AND DISCUSSION

Given the highly technical nature of utilities regulation, it is understandable that the Law Court would be reluctant to overturn a decision of the Public Utilities Commission. However, the overwhelming difference in value represented by Sempra's initial investment and Energy West's subsequent purchase raises the question of what *Bangor Gas* signals for the future of energy law and judicial review in Maine.

A. *Fundamental Principle of Utility Law*

Not surprisingly, it is rare that a utility company will be purchased for less than the value of the investments made in that company's assets.<sup>84</sup> In Maine, the Commission has had only one prior opportunity to consider the value of rate base after such a purchase and that proceeding was resolved by an agreement between the parties.<sup>85</sup> The prevailing treatment of such purchases by the Federal Energy Regulatory Commission ("FERC") is to require a "negative acquisition adjustment," whereby the value of the property is determined by the acquisition cost and the excess of the book value over the acquisition cost is treated as additional accumulated depreciation.<sup>86</sup> In one case embracing this issue, *Locust Ridge Gas Co.*,<sup>87</sup> FERC explained that this prevents a company that purchases a facility from "realiz[ing] a return on, and . . . of, a larger amount than what it invested in acquiring [that] facility."<sup>88</sup> Because the facts of *Locust Ridge* and *Bangor Gas* are similar, it is worthwhile to examine this case more closely.

In *Locust Ridge*, FERC denied Locust Ridge Gas Company's motion for a rehearing after FERC ordered the company to reduce its rate base.<sup>89</sup> Locust Ridge argued that FERC had incorrectly determined that Locust Ridge's predecessor in interest had not written down the book value of its rate base.<sup>90</sup> Because of this inaccuracy, Locust Ridge contended that FERC had erred when it allocated the loss in value reflected by this write down to the depreciated original cost of facilities.<sup>91</sup> Therefore, because the depreciated original cost had been used to determine the value of Locust Ridge's rate base, rectifying this error would result in a larger rate

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84. *Greenville Water Co., Millinocket Water Co., and Skowhegan Water Co., Application for Authorization to Sell Utility Property to Wanakah Water Co.* (35-A M.R.S.A § 1101) and to Discontinue Service (35-A M.R.S.A § 1104), No. 92-250, Order Approving Stipulation at 2 (Me. P.U.C. 1992). This order, which approved a stipulation between the parties requiring a negative acquisition adjustment that lowered the value of the utility's rate base, represents the only other time in the last sixty years where the Maine Public Utilities Commission has considered the rate treatment of a utility purchased for less than what the prior owner had invested. *Id.*

85. *Id.*

86. *See, e.g., N. Border Pipeline Co.*, 82 FERC ¶ 62,151 (1998) (final agency order approving a below book value purchase resulting in a negative acquisition adjustment); *Gulf Shore Energy Partners, LP*, 142 FERC ¶ 61227 (2013) (order approving a company's proposed negotiated rate agreements after showing compliance with a prior directive ordering the company to revise its proposed rates to reflect a negative acquisition adjustment).

87. *Locust Ridge Gas Co.*, 29 FERC ¶ 61052 (1984).

88. *Id.* at ¶ 61,114.

89. *Id.*

90. *Id.* at ¶ 61,113.

91. *Id.*

base and higher rates for the company.<sup>92</sup> In essence, this “fix” would allow the company to include the original net cost of utility property in its rate base despite having purchased the property for less than that cost.<sup>93</sup> FERC rejected this argument<sup>94</sup> stating that, due to long standing policy,<sup>95</sup> even if Locust Ridge’s assertions were true it would not be allowed an increase in rate base as that would violate the fundamental principle that investors are only allowed a return on their investment.<sup>96</sup>

When comparing the factual circumstances of *Locust Ridge* with those in *Bangor Gas*, it is evident that the core of these cases is the same. Both involve a utility that was purchased for less than the original cost and both involve an attempt by the purchasing company to use the larger original cost figure when determining the utilities’ respective rate bases. The only substantive difference is in the outcome of these cases. While the *Locust Ridge* decision only provides persuasive authority in Maine and other states, the fundamental principle, which underlies this decision, has been recognized in Maine.<sup>97</sup> In light of this recognition, the absence of any discussion of this fundamental utility law principle in the *Bangor Gas* decision is conspicuous. While this point was briefed and presented at oral argument,<sup>98</sup> the court did not respond to the contention that it has recognized this principle in previous decisions. One theory as to why this issue was not addressed is that because this principle supports accepting Energy West’s acquisition cost as the value of Bangor Gas’s rate base, the court simply did not want to confront it when affirming the Commission’s decision to reject the acquisition cost factor. By holding that the Commission has the discretion to assign the weight to the factors considered in valuing property—and therefore concluding that the Commission’s rejection of the acquisition cost factor was properly made—the Court necessarily had to overlook the substantial support that the fundamental principle gives to utilizing Energy West’s acquisition cost in determining the value of property. However, even without addressing this principle the court’s approach is flawed because it fails to acknowledge that the Commission does not have the discretion to reject consideration of a factor based on a value judgment of that particular factor’s weight.<sup>99</sup>

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92. *Id.* (referencing the prepared testimony of one of Locust Ridge’s directors wherein he states that the company’s predecessor had made the accounting entries and the value reflected by those entries should be added back to the company’s rate base).

93. *Id.* at ¶ 61,114. If this cost had been included then the value of Locust Ridge’s rate base would have been increased by \$1.1 million over the less than \$350,000 that the company paid for the property. *Id.* at ¶ 61,115.

94. *Id.* at ¶ 61,114.

95. *Id.* (“The Commission’s long-standing policy on property acquisitions is to allow a purchaser to record acquisitions at the lesser of (i) the depreciated original cost or (ii) the actual purchase price.”).

96. *See Id.*

97. *See Me. Water Co. v. Pub. Utils. Comm’n*, 388 A.2d 493 (Me. 1978); *Rangeley Water Co. v. Rangeley Water District*, 1997 ME 32, 691 A.2d 171; *see also supra* text accompanying notes 46-53.

98. Br. for Office of the Pub. Advocate at 29, *Bangor Gas*, 2015 ME 113, 122 A.3d 959 (No. PUC-14-414); Br. for Verso Paper at 36, *Bangor Gas*, 2015 ME 113, 122 A.3d 959 (No. PUC-14-414).

99. *See* 35-A M.R.S.A. § 303 (2010 & Supp. 2015); *Cent. Me. Power Co. v. Pub. Utils. Comm’n*, 150 Me. 257, 262, 109 A.2d 512, 514 (1954) [hereinafter *CMP*].

*B. Bangor Gas's Prudent Acquisition Cost Was Not Given "Due Consideration"*

When the Law Court reviews a ratemaking decision of the Commission, so long as the Commission's decision is reasonable and supported by substantial evidence, it will apply a deferential standard of review to the Commission's fact-finding and methodology adopted in the ratemaking proceeding.<sup>100</sup> However, when the Commission "abuses the discretion entrusted to it or fails to follow the mandate of the legislature," a question of fact will become a question of law, and it will be proper for the court to intervene.<sup>101</sup> In following the mandate of the Legislature, the Commission must give "due consideration" to evidence that would tend to establish any factor that is statutorily required to be considered.<sup>102</sup>

In *Bangor Gas*, this last factor was of primary importance to the court's analysis.<sup>103</sup> Citing *Central Maine Power v. Public Utilities Commission*,<sup>104</sup> the court states that although the Commission must give "due consideration" to all statutory factors, it need not give equal weight to each factor.<sup>105</sup> The court then goes on to explain that in *CMP* the Commission had acted within the bounds of its discretion when it gave little weight to the "acquisition cost" of the property included in rate base and instead weighed the "original cost" of the property more heavily.<sup>106</sup> Furthermore, the court explicitly states that this exercise of discretion was appropriate because the property in *CMP* had been substantially retired.<sup>107</sup> Therefore, in light of the court's decision in *CMP*, the court in *Bangor Gas* held that the Commission acted "[c]onsistently [within] its statutory authority when it rejected the acquisition cost factor and accepted the original cost factor as the more reasonable value on which to base Bangor Gas's base rates and resulting return on equity."<sup>108</sup> This analogy, however, is inconsistent.

In *CMP* the court stated that the Commission need not give equal weight to each statutory factor when determining the value of property included in rate base.<sup>109</sup> Yet the court went on to explain that once a factor is "well proven," that factor must be reflected in the finding of value given to the property included in rate base.<sup>110</sup> In other words, without such a "reflection" in the finding of value, it cannot be said that the factor has been "duly considered."<sup>111</sup> The Commission's decision in *CMP* was premised on the fact that because *CMP* had made its

100. *New England Tel. & Tel. Co. v. Pub. Utils. Comm'n* 470 A.2d 772, 776 (Me. 1984) (citing *Cent. Me. Power Co. v. Pub. Utils. Comm'n*, 405 A.2d 153, 182 (Me. 1979)).

101. *New England Tel. & Tel. Co. v. Pub. Utils. Comm'n*, 148 Me. 374, 377, 94 A.2d 801, 803 (1953).

102. 35-A M.R.S.A § 303 (2010 & Supp. 2015); *CMP*, 150 Me. at 262.

103. *Bangor Gas*, 2015 ME 113, ¶¶ 19-21, 122 A.3d 959.

104. 150 Me. at 262.

105. *Bangor Gas*, 2015 ME 113, ¶ 19, 122 A.3d 959.

106. *Id.* ¶ 19; *CMP*, 150 Me. at 267.

107. *Bangor Gas*, 2015 ME 113, ¶ 19, 122 A.3d 959; *CMP*, 150 Me. at 267.

108. *Bangor Gas*, 2015 ME 113, ¶ 21, 122 A.3d 959.

109. *CMP*, 150 Me. at 262.

110. *Id.*

111. *See CMP*, 150 Me. at 262.

acquisition of the property “many years ago”<sup>112</sup> and because the property was depreciable, the company’s prudent investment in the property was therefore not illustrative of the value of the property for ratemaking purposes.<sup>113</sup>

The result in *CMP* is wholly consistent with the requirement that a “well proven” factor be reflected in the finding of value. Although the company had shown that it had “prudently acquired” the property and that this acquisition cost was in excess of the “original cost” of the property, because the property had been substantially retired—and therefore not in service—and because the company had made this investment “many years ago,” the acquisition cost should not have been weighed heavily when valuing the property for the current rate-proceeding. Perhaps more importantly, because the property was depreciable, the company’s investment had already been recovered.<sup>114</sup> Therefore, evidence of the company’s “prudent acquisition cost” would not be probative of the value of the property for the purposes of allowing investors a “fair return” on their investment, and a finding that the acquisition cost should be given little weight would be a fair reflection of its probative value.

Unlike in *CMP*, the property in *Bangor Gas* had been purchased recently and had not been owned long enough to allow for any recovery through depreciation.<sup>115</sup> Also unlike the situation in *CMP*, the property in *Bangor Gas* had not been “substantially retired.” *Bangor Gas* had begun operation as a start-up gas utility in 1998<sup>116</sup> and, as the court acknowledged, the company had installed much of its infrastructure within a ten-year period beginning at the time of its operation.<sup>117</sup> While it is true that certain sections of gas pipelines had not yet been placed in service,<sup>118</sup> this was not due to the retirement of property, but was instead due to concerns of profitability and the loss of one of *Bangor Gas*’s largest customers.<sup>119</sup> Therefore, unlike in *CMP*, the acquisition cost of *Bangor Gas*’s property was an especially relevant factor in valuing the property for the purposes of setting a fair rate of return on Energy West’s investment. Thus, because of these key differences between *CMP* and *Bangor Gas*, it was erroneous for the Law Court to place any weight on its *CMP* decision in reasoning that perfunctory consideration of the acquisition cost factor could constitute “due consideration.”

In its *Bangor Gas* decision the Law Court acknowledged that the Commission did not weigh the acquisition cost factor in a vacuum, but only after reviewing the

112. The court in *CMP* does not mention exactly how “many years ago” *CMP* had acquired the property, but does use a period of forty years when determining whether the Commission’s erroneous method of calculating the original cost of the property less depreciation was prejudicial to *CMP*. *Id.* at 266.

113. *Id.* at 267.

114. *See Me. Water Co. v. Pub. Utils. Comm’n*, 388 A.2d 493, 495 (Me. 1978) (“[T]he aim of depreciation . . . is to permit a utility to recover its original investment in the property.”).

115. Whereas a total of only five years had elapsed between Energy West’s acquisition of *Bangor Gas* and the company’s petition to renew its alternative rate plan, *see Bangor Gas*, 2015 ME 113, ¶¶ 6, 8, 122 A.3d 959, in *CMP* the property had been acquired at least forty years prior to the rate-proceeding. *See CMP*, 150 Me. at 266.

116. *Bangor Gas*, 2015 ME 113, ¶ 3, 122 A.3d 959.

117. *Id.* ¶ 4.

118. *Id.* ¶ 7.

119. *Id.* ¶ 4.

original cost of the Bangor Gas property.<sup>120</sup> The court stated that the Commission's rejection of the acquisition cost was fair because the Commission gave "careful consideration" to: (1) Bangor Gas's productivity; (2) the company's ability to attract capital and realize a fair return on equity; and (3) policy concerns for rate stability.<sup>121</sup>

Although the Legislature has given the Commission wide discretion to consider any "material and relevant factors or evidence,"<sup>122</sup> the Commission's "desire to have rates increase gradually rather than suddenly is not a sufficient basis for the rejection of competent, probative evidence."<sup>123</sup> Accordingly, the Commission cannot arbitrarily disregard "evidence tending to establish any factor critical to the determination of a just and reasonable rate."<sup>124</sup> In other words, the Commission cannot wholly reject competent probative evidence based simply on a value judgment that another factor should be weighed more heavily in the analysis. Therefore, while other factors may weigh more heavily in the valuation analysis—because acquisition cost is suggestive of the value of the property—the bare weight of these other factors is insufficient to reject outright the acquisition cost when determining the value of rate base. Thus, because the acquisition cost factor was given no weight in *Bangor Gas*, and therefore not reflected in the ultimate finding of value, the Commission did not give "due consideration" to the acquisition cost of the property.

### C. *The Law Court's Rejection of OPA's Current Value Argument*

One contention that the court does address in its decision is the argument that the Commission used the statutorily prohibited "current value" factor in its order approving Bangor Gas's ARP.<sup>125</sup> As mentioned previously, when the Commission abuses its discretion or fails to follow the mandate of the Legislature, the Law Court may properly review the Commission's factual findings as questions of law and not of fact.<sup>126</sup> Therefore, any consideration of the current value of Bangor Gas's assets would fail to follow the Legislature's mandate and would be subject to reversal.

The OPA argued that the Commission's decision to ignore Energy West's purchase price of Bangor Gas was premised on the current value of Bangor Gas's assets.<sup>127</sup> To support its argument, the OPA cited language in the Commission's order stating that there was no "impairment in the functional use or revenue

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120. *Id.* ¶ 21.

121. *Id.*

122. 35-A M.R.S.A. § 303 (2010 & Supp. 2015).

123. *In re Me. Motor Rate Bureau*, 357 A.2d 518, 528 (Me. 1976).

124. *Id.*

125. *Bangor Gas*, 2015 ME 113, ¶ 22, 122 A.3d 959; *see also* 35-A M.R.S.A. § 303 (2010 & Supp. 2015).

126. *New England Tel. & Tel. Co. v. Pub. Utils. Comm'n*, 148 Me. 374, 377, 94 A.2d 801, 803 (1953).

127. Brief for Office of the Pub. Advocate at 24, *Bangor Gas*, 2015 ME 113, 122 A.3d 959 (No. PUC-14-414).

producing ability of Bangor Gas's facilities *today*,<sup>128</sup> and that the acquisition cost "would not accurately reflect the *current use* of the utility's assets."<sup>129</sup> This emphasis on the "current use" and "revenue producing ability" were, as the OPA contended, "the basic inquiry of a current value analysis."<sup>130</sup>

Responding to this argument, the Law Court stated that any discussion of Bangor Gas's facilities was undertaken only in order to determine a value of the property that would allow the company to "realize a fair return on equity in light of its current operations and service capacity."<sup>131</sup> After examining all of this evidence the Law Court held that the Commission's determination, that the original cost of the property more accurately reflected the value of the property, did not constitute an abuse of its discretion or exceed its statutory authority.<sup>132</sup>

The court's conclusion is troubling because it appears to directly contravene the fundamental principle that investors are entitled to only a return on their investment. By affirming the Commission's decision to adopt the \$38 million value represented by the original cost factor, the Law Court allowed Energy West's investors to obtain a return on an amount that is far in excess of the capital that was invested. The conclusion that the Commission's decision was appropriate because it allowed Energy West's investors to obtain a return on their equity investment "in light of [the company's] current operations and service capacity,"<sup>133</sup> cannot rest on the premise that Energy West's investors bear the risk of the 38 million dollar investment because this risk was borne, and realized, by Sempra when Sempra absorbed the loss by writing down the value of Bangor Gas's assets and selling the Company at a loss.<sup>134</sup> Similarly, while investors are entitled to sufficient revenue in order to cover the costs associated with running the utility, such costs are not included in the valuation of the utility's property, but in a separate figure.<sup>135</sup> By rejecting the OPA's contentions the court implicitly acknowledged that, despite allowing investors to recover on an amount that they did not invest, did not bear the risk for, and did not need in order to cover costs, recovery on the \$38 million was appropriate because that figure more accurately represented the "current operations and service capacity" of the utility. Assuredly, this must, at least to the OPA, sound frustratingly close to saying that the \$38 million valuation was proper because it more accurately represented the "current value" of the utility.

128. *Id.* (quoting Bangor Gas Co., LLC, Request for Approval of Renewal of Multi-Year Rate Plan (35-A M.R.S. § 4706), No. 2012-00598, Order at 14-15 (Me. P.U.C. 2014)) (emphasis added).

129. Brief for the Office of the Pub. Advocate at 24-25, *Bangor Gas*, 2015 ME 113, 122 A.3d 959 (No. PUC-14-414) (quoting Bangor Gas Co., LLC, Request for Approval of Renewal of Multi-Year Rate Plan (35-A M.R.S. § 4706), No. 2012-00598, Order at 14-15 (Me. P.U.C. 2014)) (emphasis added).

130. Brief for the Office of the Pub. Advocate at 24, *Bangor Gas*, 2015 ME 113, 122 A.3d 959 (No. PUC-14-414).

131. *Bangor Gas*, 2015 ME 113, ¶ 22, 122 A.3d 959.

132. *Id.*

133. *Id.*

134. *Id.* ¶ 5; Bangor Gas Co., LLC, Request for Approval of Renewal of Multi-Year Rate Plan (35-A M.R.S. § 4706), No. 2012-00598, Order at 11 (Me. P.U.C. 2014).

135. *See* New England Tel. & Tel. Co. v. Pub. Utils. Comm'n, 448 A.2d 272, 284 (Me. 1982) ("The purpose of rate of return is to provide a public utility sufficient revenue to cover the company's total costs of service. Those costs include both the operating expenses of the utility and an adequate return on the investment of the utility in property and equipment serving the public.").

## V. CONCLUSION

With its decision in *Bangor Gas*, the Law Court continued a long tradition of refraining from interjecting itself into the ratemaking decisions of the Public Utilities Commission. Perhaps this is understandable because the court has neither the engineering nor technical skill to decide what rates are reasonable and just.<sup>136</sup> When it comes to reviewing these decisions, however, the court's practice of judicial restraint and deference to administrative decisions may become strained when, as in this case, the review involves a mixed question of fact and law. While there is no doubt that it would be improper for the court to take upon itself the question of what constitutes a just and reasonable rate, for a system of administrative governance to succeed, the court must still ensure that the Public Utilities Commission follows the mandate of the Legislature. The role that the Law Court plays in striking the proper balance of deference to administrative bodies is particularly important when, as here, the Legislature has offered specific guidance to the Commission in the form of factors to consider in its decision-making. Thus, when the Law Court affirms a decision of the Public Utilities Commission allowing investors to recover on an investment not made, the affirmance not only runs contrary to fundamental principles of utility law, but also signals the wide discretion that the court is willing to grant the Commission in its decision-making authority. In fact, given the Commission's failure to accord any weight to Energy West's purchase price, the court's affirmance signals just how deferentially it reviews Commission orders. In other words, so long as the Commission discusses a relevant factor, the court will be unlikely to overturn the Commission's decision on the ground that it had failed to "duly consider" that factor. Thus, this decision not only diverges from the national consensus regarding the treatment of property that is purchased for less than the cost of the investments made in the property, but it also has implications for those cases that do not involve the valuation of utility property at all. The most immediate of these being that, given the wide discretion afforded to Commission decisions, those who seek to appeal a decision of the Commission on the ground that it has committed an abuse of discretion will likely think twice before doing so.

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136. See, e.g., *New England Tel. & Tel. Co. v. Pub. Utils. Comm'n*, 148 Me. 374, 377, 94 A.2d 801, 803.

