UE-032065

SUPERIOR COURT OF WASHINGTON IN AND FOR THURSTON COUNTY	
STATE ATTORNEY GENERAL, Plaintiff(s), v. STATE UTILITIES & TRANSPORTATION COMMISSION, Defendant(s).	NO. O4-2-02511-4 COURT'S OPINION **(CLERK'S ACTION REQUIRED)**

Petitioners, the Washington State Attorney General's Public Counsel Section (Public Counsel) and the Industrial Customers of Northwest Utilities (ICNU) assert, either jointly or separately, that the Washington Utilities and Transportation Commission (Commission) committed a number of errors in its final orders, the 6th and 7th Orders in Docket No. UE-032065.[1] In addressing each assignment of error, no attempt has been made to separate the arguments made by a particular petitioner because separation is unnecessary. All are identified simply as the arguments of petitioners.

This court has carefully reviewed the briefs, cited authorities, and cited portions of the record relevant to the issues presented. In addition, because of the delay in completing this task the court has also re-read the oral arguments of counsel. After this consideration I conclude that petitioners have failed to show any error and so deny their petition.

[1] Errors alleged pertain to the 6th Order, so analysis focuses on that Order.

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Procedural Issues

Petitioners assigned error to the decision of the Commission to break the Rate Plan, UE-020417, and proceed with a general rate filing. That issue is addressed in *Public Counsel v. Commission*, Court of Appeals No. 31826-1-II, August 4, 2005, and is not addressed here. However, petitioners raise two additional issues connected to UE-020417 that were not addressed by the Court of Appeals in its recent decision. Petitioners contend that the Commission's 6th Order is inconsistent with its prior order allowing the docket to be filed. Further, they contend that in its final orders, the Commission failed to address or resolve all questions of fact raised by Public Counsel and ICNU. In this regard, Public Counsel contends not that the Commission must have decided those issues in its favor, but rather it must have addressed those issues in its written decision.

No law supports petitioners' contention that the law requires that an agency's final order be consistent with its initial orders. In this case the Commission's order must be based upon the evidence and law developed in the hearings held after entry of the order breaking the rate plan. No error of law is shown here.

Similarly, the law does not require the Commission to address or resolve each question of fact raised by a litigant. RCW 34.05.461(3) governs, and provides in relevant part:

> Initial and final orders shall include a statement of findings and conclusions, and the reasons and basis therefor, on all the material issues of fact, law, or discretion presented on the record, including the remedy or sanction . . .

This provision does not require an agency to address every issue raised; rather it requires that findings, conclusions, and reasoning address the issues material to the final decision. A fair reading of the 6th Order and the record in this case leads this court to conclude that the Commission did address the material issues in the case. Since the order included deferral of many of the issues raised by petitioners, detailed reasoning and findings concerning those issues was not required for the Commission's final order or for review of that order.

The opinion in *In re Montana Power*, 126 P.U.R.4th 332, is not binding authority. Consideration of the public policy supporting the adoption in this jurisdiction of a rule requiring the

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degree of explanation found in the *Montana Power* decision is best left to the legislature or the Commission itself.

The Prudence Test

Petitioners argue that the Commission illegally authorized PacifiCorp to increase its rates. More specifically, petitioners argue the law requires the Commission evaluate whether PacifiCorp's costs were prudently incurred and benefited ratepayers; and they contend the Commission failed to do so. Further, petitioners argue that the law does not permit the Commission to include in PacifiCorp's rate base power plants that have not been proven used and useful. They contend these power plants must be removed from the rate calculation.

In considering these assignments of error, I have separated the prudence test from the benefited ratepayers test – each is a separate and distinct test.

The Prudence test. The prudence test arises from the "fair, just, reasonable, and sufficient" standard of RCW 80.28.010. It must be part of the Commission's consideration in every rate setting, but the manner in which the prudence test is considered is a matter resting within the broad discretion of the Commission. In the 6th Order, the Commission deferred prudence consideration in a specific and time-limited manner, so the manner of consideration is evident. The issue before the court here focuses directly on the manner in which Commission considered the prudence test.

The breadth of the Commission's discretion is a key issue for this court to decide; and I am guided by the discussion in *POWER (II) v.WUTC*, 104 Wn.2d 798 (1985):

> [I]t is also helpful to consider rates in the broader perspective of the functional "end result" test announced by the United States Supreme Court in *Federal Power Comm'n v. Hope Natural Gas Co.*, 320 U.S. 591, 64 S.Ct. 281, 88 L.Ed. 333 (1944); that is, that rates, no matter how they are determined, need only "enable the company to operate successfully, to maintain its financial integrity, to attract capital, and to compensate its investors for the risks assumed ..." *Hope Natural Gas*, 320 U.S. at 605, 64 S.Ct. at 289. . . . In *Permian Basin* [*Area Rate Cases*, 390 U.S. 747, 88 S.Ct. 1344, 20 L.Ed.2d 312 (1968)], the United States Supreme Court also provided the classic articulation of a reviewing court's role:
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> . . . The court's responsibility is not to supplant the Commission's balance of these interests with one more nearly to its liking, but instead to assure itself that the Commission has given reasoned consideration to each of the pertinent factors.

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Permian Basin, 390 U.S. at 792.

> While modernly a reviewing court's role in this State is delineated by the administrative procedure act, [RCW 34.05.57], these classic statements from *Hope Natural Gas* and *Permian Basin* continue to provide guidance in the judicial review of rate cases; and it remains the law that courts are not at liberty to substitute their judgment for that of the Commission. Thus, within a fairly broad range, regulatory agencies exercise substantial discretion in selecting the appropriate rate making methodology.

POWER II, at 811-12. And further:

> This is not to say, however, that a WUTC order . . . may not be reversed by the courts if the record establishes that the order was arbitrary or capricious – or is improper on some other ground within the permissible scope of judicial review as prescribed by the administrative procedure act. We must, therefore, go further and address the substance of the WUTC decision in this regard.

POWER II, at 817-18. Accordingly, this court has applied the traditional APA analysis for reviewing agency discretion: confirm that discretion has been granted by the legislature, defer to the agency's expertise; and determine whether the exercise of discretion was arbitrary or capricious. Even applying those tests, no error has been shown.

It was not error of law for the Commission to defer the prudence test. The discretion granted by the legislature in Ch. 80.28 RCW and construed in *POWER II* and other cases cited in respondents' briefs is clearly permitted so long as its exercise is not arbitrary and capricious and is supported by substantial evidence. I note further that the Commission has exercised discretion to defer prudence on several occasions over a period of years without corrective action by the legislature. If the Commission was acting beyond the limits of discretion intended by the legislature, that latter body had ample opportunity to rein it in – and did not.

The prudence deferral was part of a reasonable balancing test conducted initially at the time of the Rate Plan Order (August 9, 2000, in Docket No. UE-991832). That Order approved the settlement joined in by petitioners and thereby deferred prudence testing until January 1, 2006, at the earliest. In the 6th Order in Docket No. UE-032065, the Commission again deferred prudence testing, but ordered that

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(3)(c) By October 31, 2005, PacifiCorp will file, either in a general rate proceeding, or in an independent proceeding, a proposal to resolve inter-jurisdictional cost allocation in Washington.[2]

AR 694. The decision must be considered in context to determine if it was arbitrary and capricious. The Commission addressed the problem of inter-jurisdictional allocation of assets at length in its 6th Order, opining in relevant part:

> Inter-jurisdiction allocation of costs among the six states PacifiCorp serves has proved to be a continuing source of controversy for many years. It has been an issue in various proceedings in Washington, including PacifiCorp's two most recent contested dockets involving requests by the Company for adjustments to rates.
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> In PacifiCorp's most recent general rate filing preceding this docket, the Company proposed that costs be allocated to Washington rates according to a methodology to which Commission Staff, and other parties, strenuously objected. The proceeding, Docket No. UE-991832, was resolved on the basis of the Commission's approval and adoption of a full settlement among all parties that implicitly reserved for another day any definitive resolution of the complex issues involved in inter-jurisdictional cost allocation.[3]
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> We have come to refer to the Stipulation that the Commission approved and adopted in Docket No. UE-991832 as the "Rate Plan." In part relevant to our background discussion here, the Stipulation states:
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> 1. Rate Plan Period
> a. . . .Third, the rate plan provides that at the end of the Rate Plan Period, the Company will submit either a filing demonstrating the reasonableness of the Company's then-existing rates or a general rate filing. This filing will enable the Commission and the Parties to examine the Company's performance over the Rate Plan Period, and to evaluate the reasonableness of the Company's rates in light of the conditions that exist following the Rate Plan Period.
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> . . .
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> PacifiCorp's Washington operations have not been thoroughly reviewed on a full general rate case record in 17 years. Such an examination is long overdue and seems absolutely imperative in the wake of the recent power market crisis. It would be contrary to the public interest for us to bar this important matter from full consideration at an early date. Accordingly, we conclude that we should amend our Third Supplemental Order in Docket No. UE-991832 to the extent necessary to authorize PacifiCorp to file a general rate case prior to the end of this year as the Company has committed to do, if permitted.
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> We noted in this connection that a so-called multi-state process was underway and expected to be finalized in the near term. We noted further that the outcome of that process,

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[2] In the context of the issues facing the Commission and in this appeal, the issue of inter-jurisdictional cost allocation is tantamount to the "fair, just, reasonable, and sufficient" standard in RCW 80.28.010, including the prudence test and the used and useful test. See 6th Order, ¶43, AR 677-8.)

[3] *WUTC v. PacifiCorp,* Third Supplemental Order, Docket No. UE-991832 (August 9, 2000).

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> which was aimed at achieving a comprehensive resolution of the long-pending disputes over inter-jurisdictional cost allocation, "should inform PacifiCorp's filing with respect to the important question of inter-jurisdictional cost allocation issues."[4]

6th Order, AR 665-668. The Commission concluded the forgoing section of its 6th Order by observing, "That case [for thorough review] is before us now." [AR 668] Nevertheless, the Commission again deferred the prudence review of PacifiCorp's inter-jurisdictional assets. It approved a new rate without the review, but directed that the process of resolving all inter-jurisdictional cost issues begin in late October, 2005.

I conclude that the Commission's decision to defer prudence review is not arbitrary and capricious. Arbitrary or capricious agency action means action that is "is willful and unreasoning and taken without regard to the attending facts or circumstances." *Washington Independent Telephone Ass'n v. WUTC*, 149 Wn.2d 17, 26 (2003). Here the record discloses action that is both reasonable and clearly explained in the Commission's decision. Furthermore, the record discloses more than substantial evidence to support the attending facts and circumstances identified by the Commission in explaining its action to defer. No error has been shown here.

Counsel on both sides spent considerable energy arguing the merits of the protocols adopted by the Commission in its 6th Order and its plan to move forward to ultimate resolution of PacifiCorp's rates concurrently with its intention to resolve inter-jurisdictional cost allocation issues by interstate agreements. There is substantial evidence to support use of the Protocol and the Revised Protocol in the manner indicated in the 6th Order. The substantial evidence standard for review of agency action is highly deferential. *ARCO Products Co. v. WUTC*, 125 Wn.2d 805, 812 (1995). This is especially true when the gloss of the end result test is added to the regular substantial evidence standard of the APA. Supported by substantial evidence and explained in the Commission's 6th Order, the decision to use these protocols was not arbitrary and capricious.

Benefited ratepayers test. This is a separate test that has been approved for testing whether certain expenses should be allowed in three rather extreme instances: charitable contributions,

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[4] *Id., fn. 10.*

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employee incentives, and construction costs for uncompleted nuclear power generators[5]. It is a test applicable under the "fair, just, reasonable, and sufficient" standard of RCW 80.28.010, just as the prudence test is, and so could arguably be applied to both "O" and "B" in the equation R=O+B(r); but this court could not find any instance where it has been applied to "B" costs – probably because it would be subsumed by the used and useful test, which is exclusively a "B" test.[6] The Commission did not commit error in failing to apply it to cost of inter-jurisdictional assets here because the test does not apply; if it did, the analysis of the Commission's action here would be the same as the analysis for the prudence test, and with the same result.

The Used and Useful Test

Petitioners also assign error to the Commission's decision to include in PacifiCorp's rate base property that was not proven used and useful, in violation of RCW 80.28.250. In response, counsel for both the Commission and PacifiCorp argue that §.250 gives the Commission discretion to fix rates without determining whether the assets included are used and useful for service in this state. They appear to argue that the Commission has discretion to value assets located throughout a broad regional network without a used and useful determination.[7] This argument, if correctly understood by the court, overstates the power granted to the Commission in the statute.

RCW 80.28.250 provides, in relevant part:

> The commission shall have power upon complaint or upon its own motion to ascertain and determine the fair value for rate making purposes of the property of any public service company used and useful for service in this state and shall exercise such power whenever it shall deem such valuation or determination necessary or proper under any of the provisions of this title.

This provision grants to the Commission the power to determine the fair value of property of a public service company. However, that power is limited in two ways. First, the power to value property is

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[5] Respectively, *Jewel v. WUTC*, 90 Wn.2d 775 (1978); *U.S. Communications v WUTC* 134 Wn.2d 74 (1998) (*US West II*); and *Peoples Organization v. WUTC*, 101Wn.2d 425 (1984) (*POWER I*).

[6] See *POWER II*, at 810.

[7] This court could find no instance in any of the Orders presented where the Commission advanced that argument.

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granted only for rate making purposes.[8] Second, the power to value property, granted by §.250, is limited to property of a public service company used and useful for service in this state. Exercise of this legislative grant of power to value property is required ("shall exercise such power") whenever the Commission shall deem valuation of property necessary or proper under any provision of Title 80. In rate setting using a rate base methodology, the Commission has clearly and consistently deemed it necessary and proper to value the property of the public service company whose rates are being set. *POWER II*, at p. 810 ("regulatory commissions such as the WUTC commonly use and apply [the rate base equation].") When doing so, the Commission must determine which assets are used and useful – it has the power under §.250 to value only those properties.

However, the Commission retains broad discretion in two important respects relevant to this case. First, the phrase "used and useful" is not defined by the legislature. The Commission has discretion to develop and apply the standards it will use – and presumably these standards will certainly include formulae for valuing properties located out of state ("inter-jurisdictional cost allocation"). The Commission has not done so here. Second, the Commission has discretion in appropriate circumstances to choose another basis for fixing rates other than a complete rate base analysis. It has done so here by fixing rates on an interim basis with a concurrent plan for proceeding with more complete rate making when a reasonable and consistent formula for valuing inter-jurisdictional properties is developed by agreement or interstate compact. This exercise of discretion is reviewed on the same basis as review of the prudence test issue – and with the same result. I conclude that petitioners have failed to show that the Commission committed error of law, or acted arbitrarily or capriciously; and I conclude that there is substantial evidence to support the Commission's exercise of discretion.

Dated: October 26, 2005.

Wm. Thomas McPhee, Judge

[8] Rate making can by initiated by complaint or upon motion by the Commission, as provided in RCW 80.28.020, so the "upon complaint or upon its on motion" language in §.250 is consistent with that grant of rate making power.

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