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**THE STANDARD FOR SETTING  
UTILITY RATES IN WYOMING:  
RESTORING THE REQUIRED  
BALANCE BETWEEN INVESTORS AND  
CUSTOMERS**

*James M. Van Nostrand<sup>1</sup>*

Utilities in Wyoming are entitled to charge rates that are “just and reasonable.”<sup>2</sup> The “just and reasonable” standard is a term of art in utility rate-making, and typically requires a balancing between the interests of the owners of the utility (*i.e.*, the utility investors) and the utility’s customers.<sup>3</sup> This balancing recognizes that while utility customers should pay rates that are reasonable, the rates must be sufficient to produce a profit level that enables the utility to maintain its financial integrity and attract capital.<sup>4</sup> Decisions of the Wyoming Supreme Court through the early 1980s generally followed this principle. Beginning in 1981, however, a different principle began to emerge in court decisions involving utility rate-making: the “public interest” is of paramount concern, and the interests of the utility are “secondary.” Such a principle suggests that rather than a “balancing” of investor and customer interests, utility rates will be set in a manner that tips the scale in favor of consumers.<sup>5</sup> This tilting of the standard in favor of customers

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1. Member, Stoel Rives LLP, Seattle, Washington. B.S., University of Northern Iowa, 1976; J.D. University of Iowa College of Law, 1979; M.A. Economics, State University of New York at Albany, 1985.

2. WYO. STAT. ANN. § 37-3-101 (LexisNexis 2003). This section provides that “[a]ll rates shall be just and reasonable, and all unjust and unreasonable rates are prohibited.”

3. Federal Power Comm’n v. Hope Natural Gas Co., 320 U.S. 591 (1944) [hereinafter *Hope*].

4. Bluefield Water Works & Improvement Co. v. Pub. Serv. Comm’n of West Virginia, 262 U.S. 679 (1923) [hereinafter *Bluefield*].

5. Sean P. Madden, *Takings Clause Analysis of Utility Ratemaking Decisions: Measuring Hope’s Investor Interest Factor*, 58 FORDHAM L. REV. 427, 442-43 (1989) (citing Attorney General v. Dep’t of Pub. Utils., 455 N.E.2d 414, 420 (Mass. 1983)). One commentator concludes that “slanting the balance of interests in favor of consumers” will “unnecessarily

appears to have been unintended when first enunciated by the Wyoming Supreme Court in the early 1980s. Since then, however, the principle has been so frequently cited and relied upon that it has become woven into the fabric of utility rate-making in Wyoming.

This principle is simply wrong when applied in the context of setting utility rates. While the principle may be appropriate in other contexts – such as when two utilities file competing applications to serve a previously unserved area – it is not correct to cite the principle in cases involving the setting of utility rates. In setting utility rates, the “just and reasonable” language in the Wyoming statute obligates the Public Service Commission of Wyoming (“Wyoming PSC” or “Commission”) to satisfy constitutional standards from two United States Supreme Court decisions described as “landmark” rulings in utility rate-making: *Hope*<sup>6</sup> and *Bluefield*.<sup>7</sup> These standards require that the interests of the utility shareholders be balanced alongside the interests of utility customers.<sup>8</sup> Under these standards, the interests of the utility (and its investors) cannot be placed in a position that is “secondary,” but must be considered alongside the customers’ interests in reasonable utility rates. In fact, this article concludes that satisfaction of the interests of the utility and its owners represents a *minimum* constitutional standard that cannot be compromised in favor of customer interests.<sup>9</sup>

This article begins in Part I by examining the origins of the principle in Wyoming rate decisions that the utility interests are “secondary,” with an examination of the cases that led to its adoption by the Wyoming Supreme Court. This history shows that while the adoption of the principle may have been inadvertent, it nonetheless has been consistently and frequently cited by the Wyoming Supreme Court and the Wyoming PSC over the last twenty plus years, and continues to be cited. Part II explains why the principle is wrong, and how its application is inconsistent with the statutory regime in Wyoming as well as constitutional requirements. Part III describes the cor-

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increase investor risk” which, in turn, will require investors to demand higher returns on their investments. In the long run, “[t]he cost of new capital [will] increase and service [will] deteriorate unavoidably because of the scarcity of reasonably priced capital.” *Id.* at 443.

6. *Hope*, 320 U.S. 591.

7. *Bluefield*, 262 U.S. 679.

8. See Patrick J. McCormick & Sean B. Cunningham, *The Requirements of the “Just and Reasonable” Standard: Legal Bases for Reform of Electric Transmission Rates*, 21 ENERGY L. J. 389, 396 (2000). The traditional starting point in interpreting the term “just and reasonable” has been an analysis of the Takings Clause implications under the Fifth and Fourteenth Amendments to the Constitution. That article discusses the rate-making standard under Section 205 of the Federal Power Act, which requires “[a]ll rates and charges made, demanded, or received by any public utility for or in connection with the transmission or sale of electric energy subject to the jurisdiction of the Commission” to be “just and reasonable.” 16 U.S.C. § 824d(a)(2003).

9. See *Duquesne Light Co. v. Barasch*, 488 U.S. 299, 309 (1989) (“If the rate does not afford sufficient compensation, the State has taken the use of utility property without paying just compensation and so violated the Fifth and Fourteenth Amendments.”).

rect rate-making principle that should be stated, and offers suggestions for effecting that correction.

### I. THE ORIGINS OF THE INCORRECT PRINCIPLE

In its rate case decisions, the Wyoming PSC routinely lists a series of “general legal standards” that govern the Commission’s actions when it sets rates. In numerous decisions over the past five years, these “general legal standards” have included a reference to a 1983 Wyoming Supreme Court decision, *Mountain Fuel Supply v. Public Service Commission*,<sup>10</sup> for the proposition that when the Commission applies a public interest standard, the public interest must come “first,” and the desires of the utility are “secondary” to it.<sup>11</sup> The *Mountain Fuel* decision, in turn, cites as authority<sup>12</sup> for this principle two earlier Wyoming Supreme Court decisions: *Telstar Communications v. Rule Radiophone Service, Inc.*,<sup>13</sup> and *Big Horn Rural Electric Company v. Pacific Power & Light Co.*<sup>14</sup> Neither of those decisions involved the Commission exercising its rate-making function, however. Those decisions involved service area disputes where two utilities were competing to serve a particular area, and were seeking certification of a service territory. This section of the article examines the cases that led to the Wyoming Supreme Court’s adoption of the principle that the utilities’ interests are “secondary” to the public interest.

#### *The Big Horn Case*

In *Big Horn*, two utilities – Pacific Power & Light Company and Big Horn Rural Electric Company – were competing for the right to serve a 255-square mile area in the northeastern part of Big Horn County, Wyoming.<sup>15</sup> This area previously had been uncertificated; the record evidence

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10. *Mountain Fuel Supply Co. v. Pub. Serv. Comm’n of Wyoming*, 662 P.2d 878 (Wyo. 1983) [hereinafter *Mountain Fuel*].

11. See, e.g., *In re Cheyenne Light, Fuel & Power Co.*, Docket No. 20003-EP-01-59, 2001 Wyo. PUC LEXIS 627, ¶ 124 (Wyo. 2001); *In re Cheyenne Light, Fuel & Power Co.*, Docket No. 20003-ER-99-54, 2000 Wyo. PUC LEXIS 266, ¶ 53 (Wyo. 2000); *In re Pacific Corp.*, Docket No. 20000-EC-02-181, 2003 Wyo. PUC LEXIS 54, ¶ 83 (Wyo. 2003); *In re Kinder Morgan, Inc.*, Docket No. 30022-GI-02-3, 2003 Wyo. PUC LEXIS 69, ¶ 94, 224 P.U.R. 4th 110 (Wyo. 2003); *In re Proposed Adoption of New Rules by the Public Service Commission of Wyoming Relating to Interconnection, Compensation, Network Unbundling, Resale of Services and "I+" Equal Access by Telecommunications Companies Serving in Wyoming*, General Order No. 76; Docket No. 90000-XO-96-76, 2001 Wyo. PUC LEXIS 215, ¶ 25 (Wyo. 2001); *In re U S WEST Communications, Inc.*, Docket No. 70000-TR-98-420, 1998 Wyo. PUC LEXIS 247, ¶ 155 (Wyo. 1998).

12. *Mountain Fuel*, 662 P.2d at 883.

13. *Telstar Communications, Inc. v. Rule Radiophone Serv., Inc.*, 621 P.2d 241 (Wyo. 1980) [hereinafter *Telstar*].

14. *Big Horn Rural Elect. Co. v. Pacific Power and Light Co.*, 397 P.2d 455 (Wyo. 1964) [hereinafter *Big Horn*].

15. *Id.* at 456.

showed that the area featured “rough and mountainous” terrain and that it was “virtually uninhabited.”<sup>16</sup> The event triggering the competing applications was the contemplated construction and installation of a radar navigation facility by the Federal Aviation Agency (“FAA”) on a peak known as “Medicine Wheel,” at an elevation of approximately 10,000 feet.<sup>17</sup> The FAA asked each utility to consider extending facilities into the area for the primary purpose of furnishing a firm source of electrical power to the facility.<sup>18</sup>

Each utility made preliminary studies of the area, followed by an application to the Commission for a certificate of public convenience and necessity.<sup>19</sup> Pacific Power, for its part, proposed to construct about twenty-four miles of a new 34.5 kV line, at a cost of about \$150,000.<sup>20</sup> Big Horn proposed to extend by fifteen miles a recently constructed 12.5 kV line, at a cost of approximately \$49,300.<sup>21</sup> The evidence showed that 12 kV was the minimum voltage acceptable for electric service at the radar installation, and that the voltage factor must be maintained at that level with “rigid constancy.”<sup>22</sup> The Commission was presented with expert testimony raising concerns with the adequacy of Big Horn’s proposed 12.5 kV line inasmuch as a heavy pumping load on the same line serving the radar station “would interfere with the required critical voltage constancy to such a degree as to render the service insufficient and unfeasible.”<sup>23</sup> Evidence also showed that “a high voltage power line of heavy and substantial construction” – such as Pacific Power’s proposed 34.5 kV line – “would more aptly withstand the rigors of the elements in this steep and wind swept mountainous territory.”<sup>24</sup>

In choosing between the competing applications, the Commission identified several factors to be considered, including the qualifications and fitness of the applicants, the source and adequacy of their power supply, the proximity of their existing service facilities to the prospective loads in the area, the nature of such loads, the immediate and long term electric requirements of the area, the type of facilities each of the applicants propose to construct, the topography and rigorous climate of the area, and “above all, the

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16. *Id.* The only potential electric customers in the area at the time were a number of mountain cabins, a television microwave tower, a ski tow with related facilities, and a ranger station. *Id.* at 456-57.

17. *Id.* at 457.

18. *Id.*

19. Under Wyoming Statute, the obtaining of such a certificate was a prerequisite to constructing utility facilities to extend into the area. WYO. STAT. ANN. § 37-31 (1957). Statutes requiring utilities to obtain certificates of public convenience and necessity before constructing or extending their plant or systems (including, in Wyoming, WYO. STAT. ANN. § 37-31 (1957), and its successor statute, WYO. STAT. ANN. § 37-2-205(a) (LexisNexis 2003)), shall be referred to hereinafter as “certificate” or “certification” statutes.

20. *Big Horn*, 397 P.2d at 457.

21. *Id.*

22. *Id.* at 458.

23. *Id.* at 458-59.

24. *Id.* at 459.

overriding public interest.”<sup>25</sup> Applying these factors, the Commission found that “the overriding public interest requires that this area be served by Pacific from its more substantial and higher voltage transmission line.”<sup>26</sup> The Commission therefore granted the certificate requested by Pacific Power and denied Big Horn’s application.

The decision was appealed by Big Horn to Laramie County District Court, which affirmed the Commission’s order.<sup>27</sup> On appeal to the Supreme Court of Wyoming, Big Horn argued that there was no substantial evidence to support the Commission’s findings that the facilities proposed by Big Horn were “insufficient and unfeasible,”<sup>28</sup> or the Commission’s findings that Pacific Power’s proposed facilities would more adequately meet the “overall requirements of the public at large.”<sup>29</sup> Big Horn further claimed that the Commission’s actions were arbitrary and capricious inasmuch as the Commission failed to follow its own standards by selecting the proposal that was three times more expensive and from a supplier whose existing facilities were less proximate to the Area.<sup>30</sup> These arguments were rejected by the court, which found adequate evidentiary support for the Commission’s decision. Nor could the court find that the commission was “arbitrary in selecting the more substantial facilities,” given the record evidence showing Big Horn’s proposed facilities to be inadequate.<sup>31</sup> The Wyoming Supreme Court therefore denied Big Horn’s appeal, and affirmed the District Court’s – and the Commission’s – decision.

Of particular interest is the Supreme Court’s discussion of Wyoming’s certificate statute, title 37, chapter 31. That statute, in relevant part, prohibits a utility from constructing or extending a line, plant or system “without first having obtained from the commission, a certificate that the present or future public convenience and necessity require or will require such construction.” Under this statute, according to the opinion, the “present and future public convenience and necessity” is the “touchstone” for the exercise of the power.<sup>32</sup> To state it another way, said the court: “[T]he pub-

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25. *Id.* at 458.

26. *Id.* at 459.

27. *Id.* at 456. Judge Allen A. Pearson presided over the trial court hearing.

28. *Id.* at 459-60.

29. *Id.* at 460.

30. *Id.*

31. *Id.* at 461.

32. *Id.* at 457. (citing *Fed. Communications Comm’n v. Pottsville Broad. Co.*, 309 U.S. 134 (1940)). That case involved the U.S. Supreme Court’s interpretation of the federal “certificate” statute administered by the Federal Communications Commission, 47 U.S.C. § 151 et seq. According to that decision, “[i]n granting or withholding permits for the construction of stations, and in granting, denying, modifying or revoking licenses for the operation of stations, ‘public convenience, interest or necessity’ was the touchstone for the exercise of the Commission’s authority.” *Pottsville Broad. Co.*, 309 U.S. at 137-38.

lic interest is to be given paramount consideration; the desires of the utilities are secondary."<sup>33</sup>

In support of this proposition, the opinion cited three decisions, all of which involved the circumstance of competing applications under a certification or service territory statute.<sup>34</sup> In these circumstances, the role of the Commission is simply "to exercise its jurisdiction and to determine for the State, on a comparative basis, which of the two applicants should be awarded the right to extend facilities into an area concededly having need for electrical service."<sup>35</sup> According to the court, it is simply a factual issue of "which proposal would best serve public convenience and necessity."<sup>36</sup>

It is noteworthy that neither utility was previously serving the Area, and thus neither therefore had a "vested interest." According to the court in *Big Horn*, "[t]he discretion vested in the commission by the statute is broad indeed when, as here, no vested rights are involved."<sup>37</sup>

### *The Telstar Case*

*Telstar*, decided sixteen years later in 1980, involved a radio common carrier (Telstar Communications, Inc.) seeking to redefine its certificated service area to overlap that of a neighboring carrier (Rule Radiophone Service, Inc.). Both Telstar and Rule operated radio telephone exchange services in southeastern Wyoming.<sup>38</sup> In 1974, Rule was granted a certificate of public convenience and necessity by the Commission to serve the City of Laramie and its "surrounding territory," while Telstar was granted a certificate to serve the City of Cheyenne and "surrounding area" as its market.<sup>39</sup> Rule subsequently obtained the necessary authority from the Federal Communications Commission to install a very high frequency (VHF) transmitter on Sherman Hill, forty miles west of Cheyenne, which gave Rule the capability to serve a far more extensive area than had been certificated by the Commission.<sup>40</sup> In 1978, Rule filed a petition with the Commission seeking to redefine its certificated area to correspond to the actual reach of the signals from the transmitter, which extended far beyond Laramie to include

33. *Big Horn*, 397 P.2d at 457.

34. *Id.* (citing *Pub. Serv. Co. v. Pub. Utils. Comm'n*, 350 P.2d 543, 549, 558 (Colo. 1960), *cert. denied*, 364 U.S. 820 (1960); *Application of Trans-Northwest Gas*, 238 P.2d 1141 (Idaho 1951); *Kansas Gas & Elect. Co. v. Pub. Serv. Comm'n of Kansas*, 251 P. 1097, 1099 (Kan. 1927) [hereinafter *Kansas Gas & Electric*]).

35. *Id.*

36. *Id.*

37. *Id.* at 458 (citing *San Diego & Coronado Ferry Co. v. R.R. Comm'n of California*, 292 P. 640, 643 (1930); *Kansas Gas & Electric*, 251 P. at 1099).

38. *Telstar Communications, Inc. v. Rule Radiophone Serv., Inc.*, 621 P.2d 241, 243 (Wyo. 1980).

39. *Id.*

40. *Id.*

Cheyenne along with several other Wyoming towns.<sup>41</sup> Telstar protested the application and intervened in the proceeding, urging the Commission to disapprove what Telstar viewed as Rule's invasion of the Cheyenne market that had been certificated to Telstar by the Commission.<sup>42</sup> Pursuant to its certificate from the Commission, Telstar had commenced providing ultra high frequency (UHF) operations within its certificated area.<sup>43</sup>

Following a hearing, the Commission granted the redefinition sought by Rule, finding that it "was necessary and in the public interest."<sup>44</sup> The Commission found that the redefinition: (1) would "provide increased VHF coverage in southeastern Wyoming,"<sup>45</sup> (2) should have a "beneficial revenue impact" upon Rule's radio common carrier operations,<sup>46</sup> (3) would further the Commission's policy of "regulated competition" previously adopted by the Commission,<sup>47</sup> and (4) should act to provide increased service reliability to all Rule's customers.<sup>48</sup> Telstar appealed the Commission's decision to Laramie County District Court, which affirmed the Commission's order.<sup>49</sup>

On appeal to the Supreme Court of Wyoming, Telstar claimed that the Commission's finding of a "need" for Rule's service was unsupported by substantial evidence.<sup>50</sup> Telstar further challenged the Commission's finding that the public interest was served by duplication of services under these circumstances.<sup>51</sup> On the former point, the Supreme Court found substantial evidence supporting the Commission's finding that there was public need and convenience.<sup>52</sup> Rule offered testimony that there were already Cheyenne customers dependent upon Rule's service; Telstar's service was inadequate to serve transient customers; Rule could provide VHF service while Telstar was limited to UHF; and the public would benefit from limited competition because the competitors would offer a wider range of services.<sup>53</sup>

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41. *Id.* The towns included Pine Bluffs, Wheatland, Chugwater, Rock River, Shirley Basin, and Hanna, in addition to Cheyenne. *Id.*

42. *Id.*

43. *Id.*

44. *Id.* (citing paragraph 15 of the Commission's memorandum opinion and order).

45. *Id.* (citing paragraph 15(a) of the Commission's memorandum opinion and order).

46. *Id.* (citing paragraph 15(b) of the Commission's memorandum opinion and order).

47. *Id.* (citing paragraph 15(c) of the Commission's memorandum opinion and order). "Regulated competition" apparently referred to the Commission's policy for radio common carriers to move from a position of regulated monopoly to a policy of granting more than one certificate for utilities to operate within a particular area "as the most effective means of providing reliable service to the public." *Id.* at 245.

48. *Id.* (citing paragraph 15(d) of the Commission's memorandum opinion and order).

49. *Id.* at 241.

50. *Id.* at 244.

51. *Id.* at 245.

52. *Id.* at 244.

53. *Id.* at 244-45.



Of greater interest is the discussion regarding the finding of public interest under the certification statute. The statute at issue in *Telstar* was title 37, chapter 2, section 205(a) of the Wyoming statutes, which is the successor statute to title 37, chapter 31, the provision at issue in *Big Horn*.<sup>54</sup> The Commission had previously ruled that the certificate statute did not require exclusivity, *i.e.*, two similar utilities may have rights in the same territory, which was upheld by the Wyoming Supreme Court in *Dubois Telephone Exchange v. Mountain States Telephone and Telegraph Company*.<sup>55</sup> In the proceeding before the Commission, Telstar based its opposition to Rule's application on competitive factors.<sup>56</sup> Telstar alleged that certification of Rule into the City of Cheyenne would decrease the market available to Telstar and make Telstar's survival an economic uncertainty, given that Rule would become a bona fide competitor.<sup>57</sup> Telstar made no firm showing that the presence of Rule would be destructive, however. Telstar's president testified that it had a substantial investment in equipment and granting the Rule application "would split the open competition right down the middle, along with Mountain Bell," which provided a different mobile telephone service connecting to its land lines.<sup>58</sup>

In its opinion, the Wyoming Supreme Court found this testimony unpersuasive, describing it as "no more than an expression of fear" without any "hard evidence to support what was no more than speculation."<sup>59</sup> If the evidence is nothing "other than a fear that a certificated business will suffer," the court stated, the Commission is within its authority to grant competing rights to another utility provider.<sup>60</sup> Citing its decision sixteen years earlier in *Big Horn*, the court stated that "[t]he public interest is to be given paramount consideration," while the "desires of utility are secondary."<sup>61</sup> In other words, it is of secondary concern that a utility's economic interests may be adversely affected by allowing another supplier to offer competing service, if the public is better served thereby.<sup>62</sup> According to the court's

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54. *Id.* at 244. In 1977, WYO. STAT. ANN. § 37-31 (1957) was recodified as WYO. STAT. ANN. § 37-2-205(a), and remains the provision applicable today. Except for the relocation of the provision to a different section of the Wyoming Statutes, the wording of the statute is virtually the same in all material respects.

55. *Dubois Tele. Exch. v. Mountain States Tele. and Tele. Co.*, 429 P.2d 812 (Wyo. 1967). In the event of a conflict between two similar utilities having rights in the same territory, the Commission is authorized to make such order and prescribe such conditions as to it may seem just and reasonable. *Id.* at 816.

56. *Telstar*, 621 P.2d at 245.

57. *Id.*

58. *Id.* at 246.

59. *Id.*

60. *Id.* (citing *Dion v. Pub. Utils. Comm'n*, 192 A.2d 46 (Conn. 1963)).

61. *Telstar*, 621 P.2d at 246.

62. *Id.* According to the court's opinion, "[t]he fact that a new service may have some effect on an existing service does not preclude the creation of additional facilities." *Id.* In further explaining why the public interest is served by allowed competition in this circumstance, the court described as "a fact of life that there are situations in which competition may

opinion: "Incidental disadvantages are simply weighed in balance against ultimate public advantages."<sup>63</sup>

The court found an absence of any evidence that both Telstar and Rule could not survive and thrive in a competitive marketplace.<sup>64</sup> At the same time, said the court, the public interest is served by the dual certification, as "[t]here is obviously a demand for the radio-telephone services offered by both Telstar and Rule."<sup>65</sup> It was within the judgment of the Commission to determine what was in the public interest with respect to duplication of services, and the court found a rational view for the Commission's conclusions.<sup>66</sup> Given that the Commission's decision was not arbitrary or capricious, the Wyoming Supreme Court affirmed the District Court's action upholding the Commission's order.<sup>67</sup>

The *Telstar* case takes the analysis a step further beyond *Big Horn* in that, unlike *Big Horn*, *Telstar* involved a situation where a utility's "vested right" was at issue. *Telstar* presented testimony that its economic interest would be affected by allowing an additional provider (Rule) to offer competing services. The Commission – and subsequently the court – was thus required to weigh the "incidental disadvantages" imposed upon the vested rights of *Telstar* against the "ultimate public advantages." In that evaluation, the court reiterated its earlier finding that the interests of the affected utility (*Telstar*) were secondary to the public interests that would be served by granting the competing application.<sup>68</sup>

#### *Extending the Principle to Rate Proceedings*

Prior to 1981, the principle that the utilities' interests were "secondary" to the public interest was limited to decisions involving service territory disputes under the certificate statute. Less than six months after the *Telstar* decision, the Wyoming Supreme Court issued a decision that extended the principle to the rate-setting process. *McCulloch Gas Transmission Company v. Public Service Commission of Wyoming* involved an application by a gas distribution utility to increase its rates to pass on to its Wyoming customers certain costs that it claimed were incurred in order to secure

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serve a useful purpose in such matters as to character of service provided, courtesy and efficiency of employees, modernization of equipment, and economy of operation." *Id.*

63. *Id.* (citing *Hohorst v. Greenville Bus Co.*, 110 A.2d 122 (N.J. 1954)).

64. *Telstar*, 621 P.2d at 246.

65. *Id.*

66. *Id.*

67. *Id.* at 247.

68. *Id.* In *Big Horn*, by contrast, there was no vested interest involved since neither utility previously served the area at issue. See *Big Horn Rural Elect. Co. v. Pacific Power and Light Co.*, 397 P.2d 456 (Wyo. 1964).

gas supplies for these customers.<sup>69</sup> McCulloch had paid \$581,000 in settlement of certain litigation with Amoco Production Company.<sup>70</sup> According to McCulloch, this payment represented the “cost” of 1.13 billion cubic feet of gas rights.<sup>71</sup> McCulloch’s rate filing sought to pass this cost on in its Wyoming rates.<sup>72</sup>

The statute at issue in the proceeding was Wyoming’s rate-setting statute, title 37, chapter 3, section 101, which, among other things, requires rates to be “just and reasonable.”<sup>73</sup> In the proceeding before the Commission, the PSC Staff opposed the rate increase proposed by McCulloch.<sup>74</sup> Following the hearing, the Commission found that McCulloch had failed to carry its burden of proof to show that the proposed increase was “just and reasonable.”<sup>75</sup> The Commission therefore denied the requested increase, and McCulloch appealed the decision.<sup>76</sup> On appeal, McCulloch claimed that the Commission order was arbitrary and capricious and unsupported by substantial evidence, and that the Commission had applied the wrong standard for determining “just and reasonable” rates.<sup>77</sup> In affirming the Commission’s decision, the court agreed that McCulloch had failed to show that the \$581,000 expenditure was a “just and reasonable” cost of purchasing gas.<sup>78</sup> With respect to the adequacy of the evidence in the record, the court found “there was evidence that could reasonably be viewed as indicating that McCulloch and its subsidiaries saw a way of breaching a disadvantageous contract and passing half of the resulting liability off on the public.”<sup>79</sup> According to the court, such an expense is not “an item eligible for pass on to customers of a utility.”<sup>80</sup>

Of particular interest is the discussion regarding the standard applied

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69. *McCulloch Gas Transmission Co. v. Pub. Serv. Comm’n of Wyoming*, 627 P.2d 173 (Wyo. 1981) [hereinafter *McCulloch*].

70. *Id.* McCulloch operated a natural gas pipeline in the Powder River Basin of Wyoming. Through its pipeline, gas was transported and sold directly to individual customers as well as to the distribution companies serving Moorcroft, Newcastle and Gillette. *Id.*

71. *Id.* at 177.

72. *Id.* at 177 n.5. Commission policy at the time was to permit gas distribution utilities to pass through to their customers the increased costs they incurred to purchase natural gas supplies in the wholesale markets. *Id.* A utility seeking to pass on an expense item must show that it represents an increase in the cost of gas. *Id.* at 178.

73. *See supra* note 2 and accompanying text.

74. *McCulloch*, 627 P.2d at 176.

75. *Id.* WYO. STAT. ANN. § 37-3-106(a) (LexisNexis 2003), provides that “[a]t any hearing . . . involving an increase in rates or charges sought by a public utility, the burden of proof to show that the increased rate or charge is just and reasonable shall be upon the utility.” WYO. STAT. ANN. § 37-3-106(a) (LexisNexis 2003).

76. *McCulloch*, 627 P.2d at 176. The Commission’s decision had previously been affirmed by the District Court of Laramie County.

77. *Id.* at 177-78.

78. *Id.* at 177.

79. *Id.* at 179.

80. *Id.*

by the Commission in rejecting the rate increase. In response to McCulloch's argument that the Commission used the "wrong standard" for determining what is just and reasonable, the court's opinion states, "First what is just and reasonable is to be decided on a case-by-case basis. *The public interest is to be given paramount consideration; desires of a utility are secondary.*"<sup>81</sup>

The court in *McCulloch* thus for the first time extended the principle developed under the Wyoming certification statute to the rate-setting process.<sup>82</sup> The utilities' interests were of "secondary" concern not only when resolving disputes over competing service territory applications under title 37, chapter 2, section 205(a) of the Wyoming statutes. With *McCulloch*, the utilities' interests became secondary to the public interest when setting utility rates under title 37, chapter 3, section 101 as well. This is the first step down what ultimately proves to be a long and well-traveled – yet erroneous – path.<sup>83</sup>

The principle that utilities' interests were "secondary" to the public interest when setting utility rates was reiterated and further developed in *Mountain Fuel Supply v. Public Service Commission*, which was decided two years later in 1983.<sup>84</sup> *Mountain Fuel* involved a rate filing by Mountain Fuel Supply Company, a gas distribution utility, which sought both an interim and a permanent increase in its natural gas rates.<sup>85</sup> The Commission denied the interim increase requested by Mountain Fuel, and limited the permanent increase to \$893,000, compared to the \$2.663 million sought by Mountain Fuel.<sup>86</sup> The Commission's decision was appealed to Sweetwater County District Court, which affirmed the Commission's order.<sup>87</sup> On appeal to the Wyoming Supreme Court, Mountain Fuel raised several issues, in-

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81. *Id.* (emphasis added) (citing *Big Horn Rural Elec. Co. v. Pac. Power & Light Co.*, 397 P.2d 455 (Wyo. 1964)).

82. One explanation for this development may be that the *McCulloch* decision, issued in May 1981, was on the heels of the *Telstar* case, decided only six months earlier, in December 1980.

83. It should be noted that later in the decision, the *McCulloch* court enunciated a somewhat contradictory standard for determining "just and reasonable" rates. According to the court's decision, while "the primary mission of a regulatory body is to protect the consumer, it must 'strive to reach a balance between consumer, producer, and those whose interests fall in between.'" *McCulloch*, 627 P. 2d at 179. The particular decision cited for this principle, *Pub. Serv. Comm'n for the State of N.Y. v. Fed. Power Comm'n*, 467 F.2d 361 (D.C. Cir. 1972), was discussing the "mission" of the Federal Power Commission in implementing the Natural Gas Act (15 U.S.C. § 717). Reaching a "balance" between the interests of the utility and its customers is more favorable to the utility than relegating the utility's interests as "secondary" to the public interest, the test required by *Big Horn* and found in *McCulloch* to be applicable to the rate-setting process. As discussed in Section III below, this type of "balancing" is the proper test to be applied in setting utility rates.

84. 662 P.2d 878 (Wyo. 1983).

85. *Id.* at 879.

86. *Id.* at 880.

87. *Id.*

cluding whether the Commission's order comported with the "just and reasonable" standard of Wyoming's rate-setting statute.<sup>88</sup> Mountain Fuel also argued that the Commission's decision adopting a 14.1% return on equity was not supported by substantial evidence.<sup>89</sup> Finally, Mountain Fuel claimed that the Commission should have used a hypothetical projected test year in setting rates rather than the adjusted historic test year used by the Commission.<sup>90</sup>

Before addressing the various issues raised on appeal, the court listed the following as a governing principle in reviewing the Commission's decision on appeal: "The PSC, in exercising its statutory powers to regulate and supervise public utilities in the state of Wyoming, as provided in § 37-2-112 . . . is required to give paramount consideration to the public interest, the desires of the utility being secondary."<sup>91</sup>

Thus the ruling from *McCulloch* was endorsed and followed in a second decision involving the Commission's exercise of authority to set utility rates. As in *McCulloch*, nothing in the *Mountain Fuel* decision involved the Commission exercising its authority under the certificate statute (title 37, chapter 2, section 205(a)) under which the *Big Horn* and *Telstar* cases were decided. Rather, as in *McCulloch*, the issues on appeal concerned the Commission's implementation of its rate-setting statute, title 37, chapter 3, section 101.

Notably, the court in *Mountain Fuel* relied upon the United States Supreme Court's decision in *Hope* in rejecting Mountain Fuel's argument regarding the use of an historical test period. *Hope* was described in *Mountain Fuel* as "a case considered to be one of the landmark rulings in the area of rate making."<sup>92</sup> The court in *Mountain Fuel* relied on the portion of the *Hope* decision discussing the "end results" test.<sup>93</sup> According to the court, Mountain Fuel was, in effect, "seeking a determination by [the Wyoming Supreme Court] that the use of a methodology based upon an historical test year instead of a projected future test year will result, as a matter of law, in

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88. *Id.* at 880-81 (citing WYO. STAT. ANN. § 37-3-101 (LexisNexis 2003)).

89. *Id.* at 881.

90. *Id.* at 881. The appropriate test period was an issue because of certain off-system gas sales that Mountain Fuel made during the historical test period which Mountain Fuel claimed would not recur in the future and thus should not be reflected in setting rates. *Id.* at 883-84. Use of a projected test period would result in exclusion of these off-system sales in setting rates. *Id.*

91. *Id.* at 883 (emphasis added) (citing *Big Horn Rural Elec. Co. v. Pac. Power & Light Co.*, 397 P.2d 455 (Wyo. 1964); *Telstar Communications v. Rule Radiophone Service, Inc.*, 621 P.2d 241 (Wyo. 1980)). The statute at issue provides that "[t]he commission shall have general and exclusive power to regulate and supervise every public utility within the state in accordance with the provisions of this act." WYO. STAT. ANN. 37-2-112 (LexisNexis 2003).

92. *Mountain Fuel*, 662 P.2d at 885.

93. The court did not cite, however, the discussion in *Hope* regarding balancing between customers and shareholders required in the setting of "just and reasonable" rates.

rates which are unjust and unreasonable.”<sup>94</sup> Such a contention, said the court, was contrary to the “end results” test, stated in *Hope* as follows:

Under the statutory standard of “just and reasonable” it is the result reached not the method employed which is controlling. It is not the theory but the impact of the order which counts. If the total effect of the rate order cannot be said to be unjust and unreasonable, judicial inquiry under the Act is at an end.<sup>95</sup>

Applying the *Hope* “end results” test to Mountain Fuel’s argument regarding the required test period to be used, the court stated that “if the end result reached by the PSC complies with the ‘just and reasonable’ standard announced in the statute, the methodology used by the PSC is not a concern of this court, but is a matter encompassed within the prerogatives of the PSC.”<sup>96</sup> The court therefore rejected Mountain Fuel’s arguments regarding the particular test period to be employed by the Commission in setting rates.<sup>97</sup> With respect to Mountain Fuel’s remaining issue challenging the Commission’s rate of return findings, the court ruled that the Commission’s order contained inadequate findings to permit the court “to perform its assigned task of a meaningful judicial review.”<sup>98</sup> The case was therefore remanded to the Commission for supplemental findings explaining the Commission’s basis for choosing the rate of return recommendation offered by the Staff witness over that of the Mountain Fuel expert.<sup>99</sup>

## II. WHY THE PRINCIPLE IS WRONG

The statement in *Mountain Fuel* that when the Commission is exercising its authority over utilities the utility’s interests are “secondary” is wrong when applied in the context of setting utility rates. First, it is inconsistent with the statutory scheme in Wyoming, and disregards the fundamental difference in the purposes of the certification statute and the rate-setting statute. While the principle may be appropriate when the Commission exercises its authority under the former statute – such as when the Commission is

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94. *Mountain Fuel*, 662 P.2d at 885.

95. *Id.* (internal citations omitted) (citing *Federal Power Commission v. Hope Natural Gas Co.*, 320 U.S. 591 (1944)). See also *Duquesne Light Co. v. Barasch*, 488 U.S. 299, 310 (1989). *Duquesne Light Co.* clarified that the “end results” test “does not dispense with all of the constitutional difficulties” when a utility claims that its rates have been set at a confiscatory level: “whether a particular rate is ‘unjust’ or ‘unreasonable’ will depend to some extent on what is a fair rate of return given the risks under a particular ratesetting system, and on the amount of capital upon which the investors are entitled to earn that return. At the margins, these questions have constitutional overtones.” *Id.*

96. *Mountain Fuel*, 662 P.2d at 885.

97. *Id.*

98. *Id.* at 887.

99. *Id.* at 887-88.

considering competing applications of two utilities seeking to serve a previously unserved area – the principle cannot be applied in cases involving the Commission's rate-setting function. Second, the principle ignores the constitutional requirements associated with the "just and reasonable" language in the Wyoming rate-setting statute. The constitutional standards from *Bluefield* and *Hope* require, at a minimum, that the interests of the utility shareholders be balanced alongside the interests of utility customers, and the utility's interests cannot be assigned "secondary" importance.

### *The Statutory Scheme in Wyoming*

The "touchstone" principle under Wyoming's certificate statute under which *Big Horn* and *Telstar* were decided is the "present and future *public convenience and necessity*." In the case of *Big Horn*, two utilities were competing to serve a previously unserved area. In this context, the "desires of the utilities" being "secondary" to the "public interest" is hardly remarkable. Where two utilities are competing for an exclusive opportunity to provide electric service, one utility will lose. In deciding which utility wins and which utility loses, the Commission determines which proposal best meets the needs of the public. It is almost tautological that in that circumstance, the focus is directed at the interests of the public, without regard to any impacts that may be suffered by the utility that loses the competition.<sup>100</sup>

The *Telstar* case takes the analysis a step further given the impact on *Telstar* of granting a competing certificate to *Rule*. In that case, the "incidental disadvantages" imposed upon the vested rights of *Telstar* had to be evaluated against the "ultimate public advantages."<sup>101</sup> Just as in *Big Horn*, the fact that a utility may be adversely affected by a ruling – *Telstar's* territory being invaded by a competitor – is of no consequence where the broader public interest is served by the decision. So long as the governing statute defines its "touchstone" principle by reference to the needs or convenience of the public, the "secondary" nature of the utilities' interests – even to the point of imposing "incidental disadvantages" – is a foregone conclusion.<sup>102</sup>

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100. See *Union Pac. R. Co. v. Pub. Serv. Comm'n*, 135 P.2d 915, 917 (Utah 1943). After reviewing "many of the authorities dealing with the question," the Utah Supreme Court stated that "public convenience and necessity" should be defined so "as to encourage rather than retard the quality of the service rendered to the public to the end that both the quality and quantity of that which is offered to the public may be improved and increased. Any service or improvement which is desirable for the public welfare and highly important to the public convenience may properly be regarded as necessary." *Id.*

101. *Telstar Communications v. Rule Radiophone Service, Inc.*, 621 P.2d 241, 246 (Wyo. 1980).

102. See, e.g., Richard J. Pierce, Jr., *The Role of Constitutional and Political Theory in Administrative Law*, 64 TEX. L. REV. 469, 479-80 (1985) ("[T]he 'public convenience and necessity' standard permits, and often compels, an agency to consider explicitly any characteristic of a proposed undertaking that could conceivably be relevant to anyone's assessment of the desirability of the undertaking, such as cost, environmental impact, alternatives, and competitive impact.").

An early Kansas Supreme Court decision ranked the competing interests as follows:

In determining whether such certificate of convenience should be granted, the public convenience ought to be the commission's primary concern, the interest of public utility companies already serving the territory secondary, and the desires and solicitations of the applicant a relatively minor concern.<sup>103</sup>

Similarly, the Supreme Court of Idaho stated the following in applying the Idaho certificate statute:

The primary consideration to be determined here is not the interest of the applicant or the interest of the Company, but is the rights and interest of the people of the State and the question whether the certificate of necessity should or should not be granted should be determined in the interest of the general public.<sup>104</sup>

The Utah Supreme Court, for its part, found that the certificate statute in that state<sup>105</sup> vests the commission with broad discretion to decide whether the public is served better by the grant of an exclusive certificate (*i.e.*, a monopoly) or by competing providers, all guided by a public interest standard:

The policy as declared by the statute . . . is not one of granting monopoly in all cases, but is *one that at all times deems the public interest of paramount importance*. Such acts grew largely out of the fact that so many utilities had become in the very nature of things, virtual monopolies that it was deemed necessary to protect the public interest both as to rates and service against the evils which could flow from monopoly. The discretionary power granted the Commission by the act, to grant or withhold certificates, negatives the idea that it was intended to grant and maintain a monopoly in any field.<sup>106</sup>

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103. *Kansas Gas & Elec. v. Pub. Serv. Comm'n of Kansas*, 251 P. 1097, 1099 (Kan. 1927). This decision was cited in *Big Horn*, and seems to be a source of the language regarding the "primary concern" of the public and the "secondary" interest of the public utility companies. 397 P.2d 455, 458.

104. *In re Trans-Northwest Gas, Inc.*, 238 P.2d 1141, 1144 (Idaho 1951) (regarding IDAHO CODE § 61-526) (citations omitted)).

105. UTAH CODE ANN. § 35-6 (1935).

106. *Union Pac. R. Co. v. Pub. Serv. Comm'n*, 135 P.2d 915, 918 (Utah 1943) (emphasis added).



In other words, the certificate statute grants a commission the authority to award a utility a valuable monopoly position or, instead, to allow a competing application.<sup>107</sup> In making those decisions, the factor of "paramount importance" is the impact on the public, as that is the purpose of the statute.<sup>108</sup>

In contrast, a commission in setting rates does not have the same broad power as when it is applying a certificate statute. The Kansas Supreme Court described the difference in the two functions as follows:

The discretionary power of the commission to grant or withhold certificates of public utility companies is broader than its power to govern rates and services of such companies. In the exercise of the latter powers, the lawful scope of the commission's orders is *hedged about by statutory and constitutional guarantees and inhibitions*. In the granting or withholding of certificates of convenience, no justiciable questions touching confiscation of property or impairment of vested rights can well arise.<sup>109</sup>

The next section discusses the "statutory and constitutional guarantees and inhibitions" that "hedge" the Commission's discretion when exercising its rate-setting function.<sup>110</sup>

### *The Constitutional Requirements Associated with the "Just and Reasonable" Standard*

The *Hope* case, described in *Mountain Fuel* as "a case considered to be one of the landmark rulings in the area of rate making,"<sup>111</sup> involved the rate-setting statute under the Natural Gas Act, sections 4 and 5.<sup>112</sup> According

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107. As stated by A.J.G. Priest in his treatise on public utility regulation, "[m]ost utilities are controlled monopolies (at least to greater or lesser extents) and the certificate of public convenience and necessity, as granted, conditioned, denied, withdrawn or modified, implements that control." 1 A. PRIEST, ELEMENTS OF PUBLIC UTILITY REGULATION 347 (1969).

108. See, e.g., the forward to the California Public Utilities Code, which states that "[t]he state policy of regulated monopoly, as declared by the statute and applied by the Commission, has never gone to the length of guaranteeing monopoly, but has at all times deemed the public interest as of paramount importance." 1 A. PRIEST, *supra* note 107, at 349..

109. *Kansas Gas & Elec. v. Pub. Serv. Comm'n of Kansas*, 251 P. 1097, 1099 (Kan. 1927) (emphasis added).

110. See *In re Permian Basin Area Rate Cases*, 390 U.S. 747, 767 (1968) (acknowledging the "broad responsibilities given to the [Federal Power] Commission by Congress" under the Natural Gas Act, and stating that the Commission "must be free, *within the limitations imposed by pertinent constitutional and statutory commands*, to devise methods of regulation capable of equitably reconciling diverse and conflicting interests") (emphasis added).

111. *Mountain Fuel Supply v. Pub. Serv. Comm'n*, 662 P.2d 878, 885 (Wyo. 1983).

112. 15 U.S.C. §§ 717c, 717d. Section 4(a) of the Natural Gas Act provides that "[a]ll rates and charges made, demanded, or received by any natural-gas company for or in connec-

to *Hope*: “The rate-making process under the Act, i.e., the fixing of “just and reasonable” rates, involves a balancing of the investor and the consumer interests.”<sup>113</sup>

The Supreme Court in *Hope* described the investor interest as having “a legitimate concern with the financial integrity of the company whose rates are being regulated.”<sup>114</sup> *Hope* went on to describe the “company or investor interest” as follows:

[I]t is important that there be enough revenue not only for operating expenses but also for the capital costs of the business. These include service on the debt and dividends on the stock. By that standard the return to the equity owner should be commensurate with returns on investment in other enterprises having corresponding risks. That return, moreover, should be sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital.<sup>115</sup>

The Wyoming Supreme Court in *In re Northern Utilities Co.*<sup>116</sup> in 1952 found that the constitutional requirements of *Hope* were applicable when applying the rate-setting statute in Wyoming.<sup>117</sup> *Northern Utilities* involved a \$29.6 million rate increase request sought by Northern Utilities for natural gas furnished to consumers in the city of Rock Springs, Wyoming.<sup>118</sup> Northern Utilities had been operating at a loss, and the Commission’s order allowed the utility to increase its rates by \$16.5 million.<sup>119</sup> The natural gas consumers of Rock Springs appealed the order, which was affirmed by the Laramie County District Court.<sup>120</sup> The issue on appeal to the Wyoming Supreme Court related to the “just and reasonable” standard under the Wyoming rate-setting statute. According to the court in *Northern Utilities*, “it is apparent that Northern Utilities Company is entitled to have a rate increase that is ‘just and reasonable’ and which will be productive of a proper return on the investment.”<sup>121</sup> Citing the test from *Hope*, the court

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tion with the transportation or sale of natural gas subject to the jurisdiction of the Commission . . . shall be just and reasonable, and any such rate or charge that is not just and reasonable is declared to be unlawful.” 15 U.S.C. § 717c(a).

113. Federal Power Commission v. *Hope Natural Gas Co.*, 320 U.S. 591, 603 (1944).

114. *Id.*

115. *Id.* (internal citation omitted).

116. 247 P.2d 767 (Wyo. 1952) [hereinafter *Northern Utilities*].

117. The applicable rate-setting statute in *Northern Utilities* was WYO. STAT. ANN. § 64-201 (1945), the predecessor statute to the current rate-setting statute, WYO. STAT. ANN. § 37-3-101 (LexisNexis 2003). Section 64-201 stated, in relevant part, that “[a]ll rates shall be just and reasonable, and all unjust and unreasonable rates are prohibited.”

118. *Northern Utilities*, 247 P.2d at 769-70.

119. *Id.* at 778.

120. *Id.* at 768.

121. *Id.* at 784.

found that such a return "should be sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital."<sup>122</sup>

Applying this standard to the evidence before the Commission in *Northern Utilities*, the court stated: "A concern which is yearly in an integral and important part of the system operated at a loss can hardly be said to be in a position to promote confidence in the financial integrity of the enterprise so as to maintain its credit and to 'attract capital.'"<sup>123</sup> According to the court, the rate increase approved by the Commission in fact was "in aid of the Rock Springs customers of the Company in an effort to enable the Company to continue its functions at a profit."<sup>124</sup> The court therefore affirmed the Commission's order.<sup>125</sup>

The other landmark Supreme Court ruling, *Bluefield Waterworks Imp. Co. v. Pub. Serv. Comm'n of W. Va.*, established the test a rate order must meet in order to avoid being struck down as confiscatory.<sup>126</sup> The United States Supreme Court in *Bluefield* stated:

A public utility is entitled to such rates as will permit it to earn a return on the value of the property which it employs for the convenience of the public equal to that generally being made at the same time and in the same general part of the country on investments in other business undertakings which are attended by corresponding risks and uncertainties; but it has no constitutional right to profits such as are realized or anticipated in highly profitable enterprises or speculative ventures. The return should be reasonably sufficient to assure confidence in the financial soundness of the utility and should be adequate, under efficient and economical management, to maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public duties.<sup>127</sup>

These three tests established by the Court are commonly referred to as the comparable earnings test, the financial integrity test and the attraction of capital test.<sup>128</sup> According to *Bluefield*, rates that fail to meet these stan-

122. *Id.* (citing *Federal Power Comm'n v. Hope Natural Gas Co.*, 320 U.S. 591, 603 (1944)).

123. *Id.* at 786 (citing *Hope*, 320 U.S. at 591).

124. *Id.*

125. *Id.*

126. 262 U.S. 679 (1923).

127. *Id.* at 692-93.

128. Walter Pond, *The Law Governing the Fixing of Public Utility Rates: A Response to Recent Judicial and Academic Misconceptions*, 41 ADMIN L. REV. 1 (1989). See also Raymond F. Gorman, Martin F. Grace & Gautam Vora, *Public Utility Underwriting Costs and*

dards “are unjust, unreasonable and confiscatory, and their enforcement deprives the public utility company of its property in violation of the Fourteenth Amendment.”<sup>129</sup>

The Wyoming Supreme Court in *Mountain States Telephone and Telegraph Co. v. Public Service Commission of Wyoming* found that both *Bluefield* and *Hope* were applicable to rate-setting in Wyoming, at least with respect to setting the rate of return.<sup>130</sup> According to *Mountain States*, “[t]here is no disagreement with the leading cases regarding rate of return.”<sup>131</sup> The “capital attraction standard” for the rate of return is set out in *Bluefield*, while *Hope* established the “corresponding risk standard.”<sup>132</sup> The court in *Mountain States* found that “these standards [from *Bluefield* and *Hope*] have been incorporated into the decisions of this court by virtue of [*Northern Utilities*].”<sup>133</sup>

While these constitutional principles have been found by the Wyoming Supreme Court to be binding in setting a utility’s equity return, it is not clear that these principles flow through to a recognition that the overall rates

*Regulatory Climate: An Examination of PUC and SEC Multiple Jurisdictions*, 10 YALE J. ON REG. 17, 30 (1993).

129. *Bluefield*, 262 U.S. at 690.

130. 698 P.2d 627 (Wyo. 1985) [hereinafter *Mountain States*]. Rate of return is only one component in the rate-setting process. Rates are designed to achieve a “revenue requirement,” which is the amount of dollars the utility should receive during the first year rates are to be in effect. The formula for determining the revenue requirement (“Rev. Req.”) is defined by the following formula:

Rev. Req. = (Rate of Return times Rate Base) plus Operating Expenses. Rate of Return, or cost of capital, is composed of carrying costs on the utility’s cost of debt, cost of preferred stock (if any), and the return on equity (“ROE”) allowed by the commission on common stock. Rate Base consists of the depreciated original cost of the various assets the utility uses in order to provide utility service such as, in the case of an electric utility, its generating plants, poles and wires, and buildings. Operating Expenses are the normal operating costs incurred by the utility in providing utility service, such as salaries, fuel costs, rent, and taxes. See 1 A. PRIEST, *supra* note 107, at 47; C. PHILLIPS JR., *THE REGULATION OF PUBLIC UTILITIES* 157 (1985).

131. *Mountain States*, 698 P.2d at 632.

132. *Id.*

133. *Id.* It should be noted that the court in *Northern Utilities* did not actually cite *Bluefield* in its decision. As noted above, however, *Northern Utilities* relied heavily on *Hope* in its analysis, and *Hope* is generally viewed as a further development of the constitutional standards enunciated in *Bluefield*. Pond, *supra* note 128, at 22. According to one commentator, *Hope* “expressly endorsed the three constitutional tests of *Bluefield* – the comparable earnings test, the financial integrity test, and the attraction of capital test.” The only difference is that for purposes of applying the comparable earnings test, *Hope* refers to the return to the equity owner on his investment rather than the *Bluefield* reference to the return to the company on the fair value of its property. *Id.* at 13. This reflects the decision in *Hope* to reject the “fair value” measurement of rate base in favor of the end results test. The ‘end result’ test adopted in *Hope* is thus the “constitutionally required ‘end result’ announced in *Bluefield*.” *Id.* Cf. Frank P. Darr, *The Constitutional Limits on Ratemaking: A Response to William Pond*, 11 ENERGY L. J. 53, 63 (1990) (“Despite this strong emphasis on the investor interest . . . the [*Hope*] decision rejected the notion that the *Bluefield* standard is the required end result.”).

must meet the constitutional standards of *Bluefield*. In several decisions subsequent to *Mountain Fuel* involving the Commission exercising its rate-making function, the Wyoming Supreme Court has continued to repeat the principle from *Mountain Fuel* that the utility's interests are "secondary" to the public interest.<sup>134</sup> This result is the clear implication that the public interest can overcome the constitutional standard. Public interest considerations cannot overcome the constitutional restrictions enunciated in *Bluefield* and *Hope*, however. The Constitution would be a "dead letter" if that were the case.<sup>135</sup> In setting rates, the Commission cannot weigh the "incidental disadvantages" imposed on a utility against the "ultimate public advantages."<sup>136</sup> The statement in *Mountain Fuel* that when the Commission is exercising its authority over utilities in a rate-setting case the utility's interests are "secondary" is wholly inconsistent with the "just and reasonable" language of the Wyoming rate-setting statute and the constitutional requirements, as set forth in *Bluefield* and *Hope*.

The Wyoming PSC, for its part, states the applicable constitutional principle correctly in its discussion of the rate of return that a utility should be allowed to earn. In the portion of its orders setting forth the legal principles governing its decisions, the Commission's general statement of the law is as follows:

There are no precise bases in Wyoming law to guide the Commission in determining a utility's rate of return on equity; and, therefore, the Commission must apply its informed judgment to all of the evidence in the case. As a "traditional" rate of return case . . . the Commission must determine the reasonableness of the result of the case, including a determination of the cost of capital, in which we are still guided by the earnings and capital attractions standards of [*Bluefield*] and [*Hope*], accepted in Wyoming in [*Northern Utilities*]. A public utility remains entitled to rates which will permit it a reasonable opportunity to earn a return on its investment properly reflecting the risk of the business and which will reasonably preserve the financial soundness of the company and allow it to raise the capital needed to discharge its duty to provide service in the public

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134. See, e.g., *Mont. Dakota Util. Co. v. Wyo. Pub. Serv. Comm'n*, 847 P.2d 978, 983 (Wyo. 1993); *Tri-County Tel. Ass'n, Inc. v. Wyo. Pub. Serv. Comm'n*, 11 P.3d 938, 941 (Wyo. 2000); *Sinclair Oil Corp. v. Wyo. Pub. Serv. Comm'n*, 63 P.3d 887, 893 (Wyo. 2003). At the same time, the court has correctly applied this principle in subsequent decisions involving application of the certification statute. See, e.g., *Utah Power & Light Co. v. Wyo. Pub. Serv. Comm'n*, 713 P.2d 240, 244 (Wyo. 1986); *W. Radio Communications, Inc. v. Two-Way Radio Serv., Inc.*, 718 P.2d 15, 21 (Wyo. 1986).

135. Pond, *supra* note 128, at 19.

136. *Telstar Communications v. Rule Radiophone Serv., Inc.*, 621 P.2d 241, 246 (Wyo. 1980).

interest. Having said that, we also acknowledge that the measurement of the required level of return is not a matter of simple mathematics but is a matter requiring judgment and the employment of informed discretion. The United States Supreme Court, in *Hope*, noted that a “just and reasonable end result” is the desired outcome and that it is the end reached, rather than the method employed in achieving it, that should control.<sup>137</sup>

At the same time, however, the Commission routinely cites as another governing principle the language from *Mountain Fuel* that the utility’s interests are “secondary” to the public interest. As stated in a recent decision: “Read together, these statutes describe the basic mechanism of the public interest standard which the Commission is to follow in its decision. The public interest must come first in our decisions; and, as the Wyoming Supreme Court has stated, the desires of the utility are secondary to it.”<sup>138</sup>

Thus, the Commission – understandably – reiterates and purports to follow the principles as enunciated by the Wyoming Supreme Court. As a result, it is not clear that the equity return considerations – stated correctly by the Commission – flow through to a recognition that the overall rates must meet the constitutional standards of *Bluefield* and *Hope*.

As discussed in Section III below, the balancing of investor and customer interests required by *Hope* is the proper test to be applied in implementing Wyoming’s rate-setting statute, title 37, chapter 3, section 101. It is essential that the confusion and contradiction created by the mistaken application of the *Big Horn* and *Telstar* precedent to the Commission’s rate-making functions in the *McCulloch* and *Mountain Fuel* decisions be remedied. Section III below enunciates the correct principle to be applied, and offers suggestions for effecting that principle.

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137. See, e.g., *In re* Cheyenne Light, Fuel & Power Co., Docket No. 20003-ER-99-54, 2000 Wyo. PUC LEXIS 266, ¶ 54 (Wyo. 2000).

138. See, e.g., *In re* Cheyenne Light, Fuel & Power Co., Docket No. 20003-EP-01-59, 2001 Wyo. PUC LEXIS 627, ¶ 124 (Wyo. 2001). In other decisions, the Wyoming PSC has stated that the requirement is to give the public interest “primacy” in its decisions. See, e.g., *In re* Cheyenne Light, Fuel & Power Co., Docket No. 20003-ES-01-58, 2001 Wyo. PUC LEXIS 53, ¶ 7 (Wyo. 2001). In construing the public interest standard under the Wyoming Telecommunications Act of 1995, the Commission has referred to the *Mountain Fuel* principle as requiring “the desires of the utility [to be] still secondary to this overriding interest of the people.” See, e.g., *In re* U S WEST Communications, Inc., Docket No. 70000-TR-98-420, 1998 Wyo. PUC LEXIS 247, ¶ 155 (Wyo. 1998).

### III. THE CORRECT PRINCIPLE AND HOW TO GET IT CORRECTED

Wyoming's rate-setting statute, title 37, chapter 3, section 101, requires that "[a]ll rates . . . be just and reasonable."<sup>139</sup> The setting of "just and reasonable" rates "involves a balancing of the investor and the consumer interests."<sup>140</sup> In achieving this balancing, there is a constitutional minimum, established in *Bluefield* and reaffirmed by *Hope*, that must be satisfied. As noted above, the ruling from *Bluefield* is that rates not in compliance with its rate of return tests "are unjust, unreasonable and confiscatory, and their enforcement deprives the public utility company of its property in violation of the Fourteenth Amendment."<sup>141</sup> Thus, the balancing required under the statute must take into account these constitutional restrictions.<sup>142</sup> Stated differently, "public interest considerations can come into play only after the establishment of minimum rates meeting constitutional requirements."<sup>143</sup>

The boundaries of discretion have been described by Judge Robert Bork as follows: "In reviewing a rate order courts must determine whether or not the end results of that order constitutes a reasonable balancing . . . of the investor interest in maintaining financial integrity and access to capital markets and consumer interest in being charged non-exploitative rates."<sup>144</sup>

Thus, any balancing of investor and consumer interests can take place only within the parameters, or zone of reasonableness, bordered by the two illegal extremes: illegal confiscatory rates at the lower end and illegal exploitative rates at the upper end.<sup>145</sup> As stated by Judge Bazelon in *Washington Gas Light Co. v. Baker*:

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139. See also WYO. STAT. ANN. § 37-2-122(a) (LexisNexis 2003) (providing that in determining what are just and reasonable rates, the Commission "may take into consideration availability or reliability of service, depreciation of plant, technological obsolescence of equipment, expense of operation, physical and other values of the plant, system, business and properties of the public utility whose rates are under consideration").

140. Federal Power Comm'n v. Hope Natural Gas Co., 320 U.S. 591, 603 (1944) (emphasis added).

141. Bluefield Waterworks Imp. Co. v. Pub. Serv. Comm'n of W. Va., 262 U.S. 679, 690 (1923).

142. See *In re Permian Basin Area Rate Cases*, 390 U.S. 747, 792 (1968) (noting that in reviewing rate orders, a court must assure itself that "the order may reasonably be expected to maintain financial integrity, attract necessary capital, and fairly compensate investors for the risks they have assumed, and yet provide appropriate protection to the relevant public interests, both existing and foreseeable").

143. Pond, *supra* note 128, at 29. In any case, the "public interest" in the rate-setting process should not be equated with a perceived consumer interest in low rates. "The public interest demands, to an equal if not greater degree, financially viable utility companies which can provide adequate service to present and future consumers." *Id.* at 19 (citing *United Gas Pipe Line Co. v. Memphis Light, Gas and Water Division*, 358 U.S. 103, 113 (1958)).

144. *Jersey Cent. Power & Light Co. v. Fed. Energy Regulatory Comm'n*, 810 F.2d 1168, 1177-78 (D.C. Cir. 1987). See also *Mo. Pub. Serv. Comm'n v. Fed. Energy Regulatory Comm'n*, 234 F.3d 36, 42 (D.C. Cir. 2000).

145. Pond, *supra* note 128, at 30 .

[T]here are limits inherent in the statutory mandate that rates be “reasonable, just and non-discriminatory.” Among those limits are the minimal requirements for protection of investors outlined in the *Hope* case. And from the earliest cases, the end of public utility regulation has been recognized to be protection of consumers from exorbitant rates. Thus, there is a zone of reasonableness within which rates may properly fall. It is bounded at one end by the investor interest against confiscation and at the other by the consumer interest against exorbitant rates.<sup>146</sup>

As described in Section II above, the *Mountain Fuel* principle that the interest of the utility is “secondary” to the public interest cannot be reconciled with the required balancing of investor and consumer interests within this zone of reasonableness.<sup>147</sup>

Wyoming law must be clarified to restore the required balance between investors and customers. One means of achieving this clarification is through action by the Wyoming Supreme Court. It seems clear from the court’s decisions in *Northern Utilities* and *Mountain States* that the standards of *Bluefield* and *Hope* have been determined to be applicable in setting utility rates in Wyoming, at least with respect to setting the allowed rate of return.<sup>148</sup> The acknowledgment of this constitutional requirement has been impaired, however, by the decision in *Mountain Fuel*, and reiteration of the

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146. 188 F.2d 11, 15 (D.C. Cir. 1950), *cert. denied*, 340 U.S. 952 (1951).

147. One commentator has concluded, however, that “the public interest can justify a good deal of financial harm to utility investors without violating the Constitution.” John N. Drobak, *From Turnpike to Nuclear Power: The Constitutional Limits on Utility Rate Regulation*, 65 B.U. L. REV. 65, 67 (1985). According to Professor Drobak, the “public interest as used in the *Hope* test permits consideration of the financial impact of utility rate increases on customers,” and this “financial impact of prices on customers can be weighed against the investor interest as part of the determination of the proper level of rates.” *Id.* at 94-95. Professor Drobak concludes that “agencies can force investors to bear below normal returns to serve a public purpose.” *Id.* at 98. At the same time, however, Drobak acknowledges that “weak constitutional limitations” on rate-making can lead to “disastrous social consequences” inasmuch as “[t]he lowest nonconfiscatory rate will rarely be the most socially beneficial rate.” *Id.* at 124. According to Drobak, while harm to the investor interest may benefit consumers in the short run, it “can cause even greater long-term harm to the public.” *Id.* at 124-25. “Excessively low utility rates can make obtaining new capital prohibitively expensive, they can induce utilities to defer needed construction projects until the utilities receive adequate assurances that investors will not bear most of the risks, and low rates can lead to a decrease in the quality of the utilities’ services.” *Id.* at 125. See also A. Lawrence Kolbe and William B. Tye, *The Duquesne Opinion: How Much “Hope” Is There for Investors in Regulated Firms?* 8 YALE J. ON REG. 113, 154 (1991) (“An economic environment with increasing business risk, combined with a perception of high regulatory risk, may cause serious problems, including underinvestment in regulated industries and economically inappropriate incentives for industry operation.”).

148. See *Dubois Tel. Exch. v. Mountain States Tel. and Tel. Co.*, 698 P.2d 627 (Wyo. 1985).



*Mountain Fuel* principle in subsequent decisions. From this article's review of the relevant decisions – *Big Horn*, *Telstar*, *McCulloch*, and *Mountain Fuel* – it seems apparent that the extension of the *Big Horn* and *Telstar* precedent under the certificate statute to the rate-making context may have been unintentional. Regardless of its origins, however, the principle that the utility's interests are "secondary" has been repeated so often, in decisions of both the Wyoming Supreme Court and the Commission, that the "just and reasonable" standard of title 37, chapter 3, section 101 has been virtually stripped of its constitutional protections. The Wyoming Supreme Court should clarify that (1) the interests of the utility are "secondary" to the public interest only in the context of service territory disputes under the certificate statute (title 37, chapter 2, section 205(a)), and (2) the "just and reasonable" standard under title 37, chapter 3, section 101 requires a balancing of customer and investor interests in a manner consistent with the constitutional requirements of *Bluefield* and *Hope*.

In the absence of clarification by the Wyoming Supreme Court, legislation may be necessary to correct the state of the law in Wyoming. Other states have statutes that clearly prescribe the balancing of customer and shareholder interests that must occur when setting utility rates. Although virtually every state incorporates the "just and reasonable" standard in its rate-setting statute, many states have gone beyond that standard to further develop how "just and reasonable" is determined. Oregon, for example, states as follows in its rate-setting statute:

The commission shall balance the interests of the utility investor and the consumer in establishing fair and reasonable rates. Rates are fair and reasonable for the purposes of this subsection if the rates provide adequate revenue both for operating expenses of the public utility or telecommunications utility and for capital costs of the utility, with a return to the equity holder that is:

- (a) Commensurate with the return on investments in other enterprises having corresponding risks; and
- (b) Sufficient to ensure confidence in the financial integrity of the utility, allowing the utility to maintain its credit and attract capital.<sup>149</sup>

This statute essentially codifies the constitutional requirements of *Bluefield* and *Hope*. The Utah statute, for its part, provides that "just, reasonable, and adequate" rates should "maintain the financial integrity of pub-

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149. OR. REV. STAT. § 756.040 (2003).

lic utilities by assuring a sufficient and fair rate of return.”<sup>150</sup> Illinois law requires utilities to be “allowed a sufficient return on investment so as to enable them to attract capital in financial markets at competitive rates.”<sup>151</sup>

If the slate were clean, the “just and reasonable” standard in title 37, chapter 3, section 101 of the Wyoming statutes arguably would be sufficient, without further elaboration, to capture the required balancing of customer and investor interests.<sup>152</sup> As noted above, most states rely on a bare-bones “just and reasonable” standard. Given the state of the law in Wyoming over the twenty-plus years since *McCulloch* and *Mountain Fuel*, however, the “just and reasonable” standard cannot be presumed in Wyoming to have the same meaning ascribed to it in other states. One way or the other, it must be clarified that the interests of the utility are not of “secondary” concern in setting rates in Wyoming. Utilities operating in Wyoming must have the assurances that the rate-setting process comports with constitutional requirements. According “secondary” status to the interests of the utility fails to comport with these requirements.

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150. UTAH CODE ANN. § 54-4a-6(4)(a) (2003).

151. 220 ILL. COMP. STAT. 5/1-102(a)(iii) (2003).

152. It should be noted that Wyoming law already elaborates on the factors to be considered in setting “just and reasonable” rates. The factors cited in title 37, chapter 2, section 122, however – availability or reliability of service, depreciation of plant, technological obsolescence of equipment, expense of operation, physical and other values of the plant, system, business and properties of the public utility – fail utterly to mention the comparable earnings, financial integrity or attraction of capital standards that are required by *Bluefield* and *Hope*. WYO. STAT. ANN. § 37-2-122 (LexisNexis 2003).

