STATE OF WISCONSIN : CIRCUIT COURT : DANE COUNTY

THE ALLIANCE FOR SOLAR CHOICE *et al.*,
Petitioners,

v.

PUBLIC SERVICE COMMISSION OF WI,
Respondent, and

WISCONSIN ELECTRIC POWER COMPANY,
Intervenor-Respondent.

Case No. 15-CV-0153

Case Code: 30607
Administrative Agency Review

Hon. Peter Anderson

SUPPLEMENTAL BRIEF OF WISCONSIN ELECTRIC POWER COMPANY

The Court has asked the parties to explain and apply two concepts of utility law: (1) the notion that when the Public Service Commission ("Commission") sets public utility rates, it does so in its "legislative capacity," and (2) the notion that "discrimination" is not permitted in public utility rates. Wisconsin Electric Power Company ("Wisconsin Electric") submits this supplemental brief in answer to those questions.

The short answer to each question is straightforward. To say that the Commission acts in its legislative capacity when setting public utility rates means that the Commission can design rates (including cost recovery mechanisms) to advance policy objectives, and that the policy objectives embraced by the Commission may not be overruled by the courts unless they are arbitrary or capricious -- that is, so unreasonable that a reasonable person could not reach the same conclusion as the Commission on the basis of all the evidence in the record and reasonable inferences therefrom. This "legislative capacity" is the very basis for the great weight deference courts are to apply in reviewing the Commission's rate-setting decisions. As for the second question, "discrimination" in the public utility context has nothing to do with the notion of "treating like alike" familiar from equal protection law. Instead, the prohibition on discrimination simply means that the utility must adhere uniformly to its published rates.

I. Acting in its "legislative capacity," the Commission exercises authority delegated by the Legislature to advance public policy through rates.

The notion that the Commission acts in a legislative capacity when setting rates can be traced back to at least 1922, in the case of *City of Eau Claire v. Railroad Commission*, 178 Wis. 207, 189 N.W. 476. In *City of Eau Claire*, our Supreme Court explained that "the regulation of rates is exclusively a legislative function," that the Commission is a "rate-making body created by the Legislature" and "is authorized to prescribe [rates] pursuant to legislative authorization," that the Commission sets rates pursuant to "the legislative command to the Commission to ascertain the reasonable rate," and that in doing so, the Commission acts on behalf of the Legislature such that its decisions are in effect "[r]ates fixed by the Legislature." *Id.* at 479-80.

Notably, the court in *City of Eau Claire* also made clear the implications of the Commission's expertise in the rate-setting domain:

> The fixing of rates is a complicated problem, calling for expert and scientific knowledge. The rate promulgated by the Commission is generally the result of mature consideration on the part of those having expert and technical knowledge which is essential in arriving at just and correct conclusions. The announcement of the Commission should be accorded the greatest deference by the courts, and its orders should be set aside because of presumed errors of judgment or technical computation, with great caution and reluctance.

Id. at 478. In more recent years, this standard of review has come to be known as great weight deference. It flows directly from the fact that in setting rates, the Commission is exercising authority delegated by the Legislature in an area of great technical complexity.

Decisions after *City of Eau Claire* elaborated on the implications of this framework for the Legislature, the Commission, and the courts. In *Wisconsin Telephone Co. v. Public Service Commission*, 232 Wis. 274, 287 N.W. 122 (1939), the court explained: "The Commission does not in establishing a rate exercise the full power of the Legislature in that regard although the nature of the power it does exercise is legislative. Delegation of legislative power is sustained

upon the ground that some standard for its exercise be set up and in addition thereto the Legislature in making the delegation may prescribe the manner of the exercise of the delegated power." *Id.* at 131. The court went on to explain that the standard for the Commission's exercise of delegated legislative power is to be found in the statutes requiring that rates be reasonable and not unjustly discriminatory -- the very requirements at issue in this case. *Id.* In most cases, those standards are to be enforced by the Commission itself. *Id.*

Even in Chapter 227 review proceedings, owing to the nature of the legislative authority exercised by the Commission, the judicial role in reviewing the Commission's orders is narrow. "The legislature has seen fit to endow the commission with extraordinary power. This is because the members of the commission are experts in the field of utility regulation or they employ experts with particular skills in that field." *City of St. Francis v. Public Service Commission*, 270 Wis. 91, 98, 70 N.W.2d 221 (1955). "The court must . . . recognize that the commission has expert knowledge, that such knowledge may be applied by it, and that even though we might differ with the commission, we are without power to substitute our views of what may be reasonable." *Milwaukee Elec. Ry. Transp. Co. v. Public Service Commission*, 261 Wis. 299, 302-03, 52 N.W.2d 876 (1952).

Moreover, with respect to rate-making decisions in particular, the courts' reviewing authority does not reach matters of rate design at the level of individual tariffs. Wisconsin's controlling legal authority on this point is *City of West Allis v. Public Service Commission*, 42 Wis. 2d 569, 167 N.W.2d 401 (1969). There, our Supreme Court explained:

> It is [the utility's] responsibility to prove its cost of services as a whole and to show the Commission what total revenue or rate will give it a reasonable return. Concededly, this it has done. No such duty lies in connection with 'pricing' the product to a particular class of customers or to customers within a class. The function of absolute obeisance to the cost-of-service principle ends when the rate level of the utility as an entity is determined.

Id. at 575 (emphasis added). In other words, "there is no 'royal road' leading from costs to rates." *Id.* at 577. Instead:

> It is well established that the Commission in designing a rate structure to recover the revenue to which [a utility] is entitled, as shown by a cost analysis, has wide discretion in determining the factors upon which it may base its precise rate schedule. It is not required to apply a cost-of-service formula to each class of customer or to each customer within a class.

Id. (emphasis added). Again, this rule stems directly from the legislative function exercised by the Commission in setting rates: "[T]he legislative discretion implied in the rate making power necessarily extends to the entire legislative process, embracing the method used in reaching the legislative determination as well as that determination itself." *Id.* (*quoting Permian Basin Area Rate Cases*, 390 U.S. 747, 776-77 (1968)) (internal punctuation omitted).

With respect to judicial review of the Commission's rate orders, the *West Allis* decision clearly draws the line at the nexus between total costs and how those total costs are recovered through rates. The utility is required to justify its total costs (plus a reasonable rate of return). If it cannot do so, the Commission will not approve recovery of those costs in rates. But beyond that line -- in the realm of further line-drawing that is rate design -- "absolute obeisance to the cost-of-service principle ends." *West Allis*, 42 Wis. 2d at 575. Recall that rate design is revenue-neutral. The utility's rates, as a whole, are calculated to recover its costs, but the Commission has no further obligation to perfectly align rates with costs -- not for "each class of customer," and certainly not for "each customer within a class." *Id.* at 577.

At the oral argument in this proceeding, the Court inquired whether, notwithstanding these points, the utility is nevertheless obligated to align rates with costs if it sets out to do so -- i.e., if it announces cost causation as its standard, as Wisconsin Electric did here. No such requirement exists in the law -- and if it did, it would be impossible to fulfill. Cost causation is always the theoretical basis for rate design, but a perfect alignment of costs and rates is possible

only in theory. Again, the *West Allis* decision speaks to this point:

> [O]ne might suppose that 'the theory' of public utility rate structures or rate differentials would call for the acceptance of no basic principle of reasonable or nondiscriminatory rates other than a mere extension of the very principle already accepted in the determination of entire rate levels, namely, the principle of service at cost. Just as, under the fair-return standard, rates as a whole should cover costs as a whole, so the rates for any given class of service (passenger versus freight, residential versus commercial, etc.) should cover the costs of supplying that class, and so the rates charged to any single customer within that class should cover the costs of supplying this one customer. Under this assumption, the theory of rate structures would be reduced to a mere theory of cost determination through the aid of modern techniques of cost accounting and cost analysis.
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> Unfortunately, however, no such simple identification of 'reasonable' rates with rates measured by costs of service is attainable; and this for several reasons [...] [T]he attempt to estimate what part of the total cost of operating a utility business constitutes the cost of serving each individual consumer or class of consumers would involve a hopelessly elaborate and expensive type of cost analysis.

Id. at 575-76 (*quoting* Bonbright, *Principles of Public Utility Rates*, at 295-97).

It is for this very reason that the Commission is given such wide discretion in matters of rate design, as are similar agencies around the country. *West Allis*, 42 Wis. 2d at 578 (collecting cases). Thus "[i]t seems clear that no responsibility rests upon the Commission to make the exacting type of cost study that is urged by the appellants. It is sufficient that there be, as there is here, substantial evidence in the record to support the rate as a whole." *Id.* (emphasis added). To go beyond this inquiry is to cross the line separating the judicial from the legislative domain. Here, it must be emphasized that the Petitioners challenge one component of one tariff among the 37 tariffs that make up Wisconsin Electric's "rate as a whole." In doing so, they invite the Court to go well beyond the line drawn around rate design in the *West Allis* decision.

Finally, while cost causation is an important feature of rate design, the Commission may use rates to advance other policies it views as equally or more desirable. *See, e.g., Wisconsin Ass'n of Manuf. & Commerce, Inc. v. Public Service Commission*, 100 Wis. 2d 300, 305, 301 N.W.2d 247 (1981) ("*WAMC*") (Commission may consider policy objectives in setting rates and

enforce those policies through rates). This is part and parcel with the Commission's legislative function in setting rates, and -- like the great weight deference standard discussed above -- can be traced back to at least the 1920s. *See Waukesha Gas & Electric Co. v. Railroad Commission of Wisconsin*, 181 Wis. 281, 194 N.W. 846, 850 (1923) ("In building up the rate, the Commission must necessarily consider not only the legal rights of the parties, but, as has been pointed out, matters of public policy, and must give weight to the various factors entering into the problem"). By contrast, once the Commission has done so, "[t]he court must and should in its deliberations exclude questions of public policy. The determination of matters of policy rests with the Legislature." *Id.* at 849.

Here, separate and apart from the questions of cost causation raised by the Petitioners, the Commission clearly stated a policy preference for maximizing the accuracy of price signals now, in the early days of an anticipated expansion of the market for distributed generation:

> The Commission finds, based upon the facts and as a matter of public policy, that there are utility fixed costs that are not being borne by DG customers and a change should be made now before those costs grow with increased adoption of DG. The use of distributed generation is expected to continue to increase and it is important for those making such investments to understand the real costs and benefits of those investments and make informed choices.

R.49 at 82; *see also id.* at 58 (noting Commission's legislative mandate to incentivize behavior "as a matter of sound public policy" through rates). This policy determination falls within the legislative domain, and is not to be revisited by the courts.

II. In the context of utility rates, the prohibition on discrimination simply means that the utility must adhere to its published tariffs.

"Discrimination" means something very different in the utility context than in the more familiar context of civil rights law. Here, it means deviating from a filed rate. To the extent Wisconsin cases have discussed utility "discrimination" at all, it was only in this narrow sense. No Wisconsin cases support the equality-based argument suggested by Petitioners here.

Before reaching that point, however, the Court should scrutinize what the Petitioners did and did not argue in their briefs. While the concept of "discrimination" occupied much of the recent oral argument, it was at best an afterthought in briefing. In their initial brief, the Petitioners argued that the Demand Charge was "discriminatory" for two reasons: (1) because customers in other classes (namely, those on the Cg 2, Cg4 and Cp4 tariffs) either do not pay a demand charge as such (Pet. Br. at 26-27) or pay a different demand charge (*id.* at 28-29), and (2) because the Demand Charge may recover more from larger customers (*id.* at 27-28). The Respondents responded with case law establishing that there is nothing "discriminatory" about charging different rates to different customer classes. *See* WE Br. at 34-35. The Petitioners did not reply; indeed, the word "discriminatory" does not even appear in their reply brief.[1] And critically, in this review proceeding, the Petitioners never argued that the Demand Charge is "discriminatory" on the basis first suggested by the Court at oral argument -- i.e., that it charges a "conservation" customer less than a "self-generating" customer for the same amount of energy.[2]

The Petitioners have submitted no Wisconsin authority rejecting a public utility tariff because customers under a different tariff may pay a different rate for the same amount of electricity. Nor will they likely find any. While it is true that the public utility statutes permit consumers to challenge rates that are "unjustly discriminatory," Wis. Stat. § 196.26(1)(a), the statutes themselves make clear that the meaning of "discriminatory" in this context is very

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[1] In the appellate context, which is analogous to the Court's function here, arguments left unaddressed in an appellant's reply brief are deemed admitted. *See, e.g., State v. Eison*, 2011 WI App 52, 33 n.7, 332 Wis. 2d 331, 797 N.W.2d 890.

[2] In a single sentence in their Petition for Review filed January 22, 2015, the Petitioners did claim that "the PSCW's order unlawfully discriminates against customers who reduce their electricity purchases from WEPCo using self generation by not imposing the same charge for customers with similar load profiles due to infrequency of electricity use or conservation measures." Pet. at 4. However, the next sentence makes clear that this is really a "substantial evidence" argument, and in any event Petitioners never developed this argument in any of their briefing. This constitutes waiver. *See City of Milwaukee v. Burnette*, 2001 WI App 258, ¶ 14, 248 Wis. 2d 820, 637 N.W.2d 447 (contentions not briefed are waived, and court need not consider "amorphous and insufficiently developed" arguments) (collecting cases).

narrow. Just four sections before Wis. Stat. § 196.26, Wis. Stat. § 196.22 states:

> **Discrimination forbidden.** No public utility may charge, demand, collect or receive more or less compensation for any service performed by it within the state, or for any service in connection therewith, than is specified in the schedules for the service filed under s. 196.19, including schedules of joint rates, as may at the time be in force, or demand, collect or receive any rate, toll or charge not specified in the schedule.

Thus, in the context of public utility rates, "discrimination" simply means charging customers a rate other than the published rates approved by the Commission. This notion of "discrimination" merely invokes the filed rate doctrine. *See GTE North Inc. v. Public Service Commission*, 176 Wis. 2d 559, 569-70, 500 N.W.2d 284 (1993) ("Section 196.22, Stats., is a statutory expression of the filed rate doctrine. The doctrine generally forbids a regulated utility to charge rates for its services other than those properly filed with the appropriate regulatory authority").

In *GTE*, the Supreme Court concluded that fees collected by the utility in violation of its filed tariffs was "unjustly discriminatory," and that the Commission was therefore authorized to order a refund under Wis. Stat. § 196.37.[3] Similarly, in *City of De Pere v. Public Service Commission*, 266 Wis. 319, 63 N.W.2d 764 (1954), the Supreme Court upheld the Commission's order vacating a water main extension charge assessed by the City of De Pere without Commission approval. Respondents are not aware of any Wisconsin decision invalidating a public utility tariff as "discriminatory" because similarly situated customers under a different tariff paid different rates. That simply isn't what "discriminatory" means in this context.

To be sure, Wisconsin courts have considered whether utility rates are "discriminatory" in other senses, including the sense proposed by Petitioners here, but only to reject such challenges. The applicable case law makes clear that differential pricing, in the sense objected to by

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[3] Wis. Stat. § 196.37 authorizes the Commission to overturn a tariff for the same reasons that a customer is permitted to complain of a tariff under Wis. Stat. § 196.26(1)(a). In *GTE*, the court described Chapter 196 as "aimed at remedying utility price discrimination," meaning "cases where utilities have provided untariffed services or charged a rate higher than its tariffed rate." 176 Wis. 2d at 569. Similarly, the court explained that they way to "control price discrimination" under the utility statutes is "through strict application of the filed rate doctrine." *Id.* at 570. None of this has anything to do with perceived pricing differences across tariffs.

Petitioners, is perfectly acceptable and indeed inherent in the ratemaking process. *See Wisconsin Ass'n of Mfrs. & Commerce, Inc. v. Public Service Commission*, 94 Wis. 2d 314, 325, 287 N.W.2d 844 (Ct. App. 1979) ("Differential pricing, i.e., different schedules of rates for different classes of customers and services, is an entirely lawful and economically desirable form of price discrimination, insofar as regulated public utilities are concerned") (*citing West Allis*, *supra*), *appeal dismissed*, *WAMC*, *supra*; *Village of Fox Point v. Public Service Commission*, 242 Wis. 97, 102-03, 7 N.W.2d 571 (1943) ("Once it is established that the services are different, a difference in the rates for each is immaterial so far as lawfulness is concerned").

Here, the law does not require identical treatment for customers on Wisconsin Electric's "ordinary" residential tariff (Rg-1) and distributed generation customers on either the COGS-NM or COGS-NP tariff. With respect to those groups, "the services are different" (*Fox Point*), and the COGS tariffs -- as distinct from the Rg-1 tariff -- are different "rates for different classes of customers and services" (*WAMC*). COGS customers' demand can be metered feasibly, they require "standby" or backup services that Rg-1 customers do not, and they (unlike Rg-1 customers) can either sell their excess energy to the utility or use net energy billing to effectively run their meters in reverse. Again, Wisconsin Electric does not argue that these customers cause different costs; the issue is that Wisconsin Electric needs a different mechanism to recover the same costs from those customers. The Demand Charge is that mechanism, and recovers fixed costs that Rg-1 customers pay through their variable energy charge. The price differential (if any) resulting from the use of these different mechanisms may mean they are imperfect, but reasonableness does not require perfection, and imperfect or differential pricing does not equal "unjust discrimination" in any sense prohibited by Wisconsin utility law.

Dated this 15th day of September, 2015.

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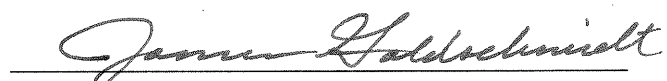

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CERTIFICATE OF SERVICE

I hereby certify that on September 15, 2015, I caused to be mailed a true and correct copy of the foregoing brief to the following parties via First Class U.S. Mail:

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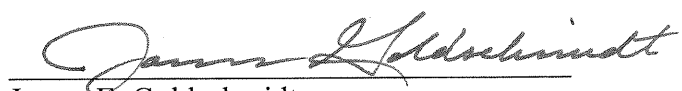

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