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Justin C. Stewart, George L. Gigi, A. Earl Cox,
Barbra Toomer, Ronald Turpin, and Pat Coryell v.
Utah Public Service Commission and U.S. West
Communications, Inc. : Brief of Respondent

Utah Supreme Court

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UTAH
SUPREME COURT
BRIEF
45.9
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DOCKET NO. _____

SUPREME COURT,
BRIEF.

IN THE UTAH SUPREME COURT

Justin C. Stewart, George L. Gigi,
A. Earl Cox, Barbara Toomer,
Ronald Turpin and Pat Coryell,

Appellants

vs.

Utah Public Service Commission and
U S WEST Communications, Inc.,

Respondents.

Case No. 910405

Argument Priority No. 10

**BRIEF OF RESPONDENTS UTAH PUBLIC SERVICE COMMISSION, DIVISION
OF PUBLIC UTILITIES, AND U S WEST COMMUNICATIONS, INC.**

PETITION FOR REVIEW FROM THE UTAH PUBLIC SERVICE COMMISSION

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UTAH

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STATEMENT OF JURISDICTION

The Utah Supreme Court has jurisdiction over this appeal under Article VIII, Section 3 of the Utah Constitution, Utah Code Ann. §§ 63-46b-16(1) and 78-2-2(3)(e)(i), and Rule 14, Utah Rules of Appellate Procedure (URAP).

STATEMENT OF THE ISSUES

1. Where Appellants seek to have Utah Code Ann. § 54-4-4.1¹ declared unconstitutional, yet no plan under that statute is in effect, is the appeal on constitutional issues moot?

Standard of Review:² Mootness is a question of jurisdiction, which may be raised at any time, and which this Court may address as a question of law. *See* Rule 37(a), Utah Rules of Appellate Procedure. Thus, this issue is a general question of law. Furthermore, this Court may grant relief from an order of the Public Service Commission *only if* the Appellants have been substantially prejudiced. Utah Code Ann. § 63-46b-16(4).

2. Is Section 54-4-4.1(1), vesting authority in the Public Service Commission to adopt, by rule or order,

any method of rate regulation consistent with this title, including a method whereby revenues or earnings of a public utility above a specified level are equitably shared between the public utility and its customers,

a. an unconstitutional delegation of legislative power;

¹ Hereinafter, statutory references will be to Utah Code Ann. unless otherwise noted.

² Appellants failed to state the standard of review and supporting authority for any of the issues they raised, as required by Rule 24(a)(5), URAP.

- b. an unconstitutional delegation of judicial power; or
- c. an unconstitutional denial of due process?

Standard of Review: These are general questions of law to be reviewed under the correction-of-error standard. Savage Industries v. Tax Comm'n, 811 P.2d 664, 666-67 (Utah 1991); Utah Dept. of Admin. Serv. v. Public Serv. Comm'n, 658 P.2d 601 (Utah 1983).

3. Does a public utility's power to reject a revenue sharing plan under Section 54-4-4.1(2) constitute an unconstitutional delegation of legislative or judicial power, or a denial of due process to a third party?

Standard of Review: These are general questions of law to be reviewed under the correction-of-error standard. Savage Industries v. Tax Comm'n, 811 P.2d 664, 666-67 (Utah 1991); Utah Dept. of Admin. Serv. v. Public Serv. Comm'n, 658 P.2d 601 (Utah 1983).

4. Are Appellants entitled to attorney's fees and/or costs, where they are not provided for by statute or contract?

Standard of Review: Since this issue is raised for the first time on appeal, it is a question of law for this Court to determine.³

5. Did Appellants properly marshal the evidence relating to the Public Service Commission's adoption of a 12.2 % rate of return, and if so, was the Public Service Commission's adoption of a 12.2 % rate of return supported by substantial

³ In Section VII, *infra*, U S WEST points out that Appellants' request for attorney's fees, among other things, is an inappropriate attempt to invoke this Court's original jurisdiction and that Appellants have not presented a factual basis for attorney's fees.

evidence?

Standard of Review: The question whether Appellants properly marshalled the evidence is a question of law for this Court. First Nat'l Bank v. County Bd. of Equalization, 799 P.2d 1163, 1165 (Utah 1990); Grace Drilling Co. v. Board of Review, 776 P.2d 63, 68 (Utah App. 1989). The review of the Commission's rate of return finding is to be made under the substantial evidence test, under which it will be sustained if "supported by substantial evidence when viewed in light of the whole record." Utah Code Ann. § 63-46b-16(4)(g). Utah Dept. of Admin. Serv., *supra*, 658 P.2d at 608.

DETERMINATIVE CONSTITUTIONAL PROVISIONS AND STATUTES

The following constitutional provisions and statutes, which are set forth fully in Addendum A to this Brief, are determinative of the issues in this case:

Constitutional Provisions: Utah Const. Art. I, Sec. 7; Art. V, Sec. 1; Art. VI, Sec. 1; Art. VIII, Sec. 1, and Art. XII, Sec. 20.

Statutes: Sections 54-3-1, 54-3-7, 54-4-1, 54-4-4, 54-4-4.1, 54-7-12, 63-46b-10, and 63-46b-16(4).

STATEMENT OF THE CASE

While most of Appellants' Statement of the Case is correct, there are some errors and omissions.

Appellants assert that the filing for an earnings sharing plan by Respon-

dent U S WEST Communications, Inc. (hereinafter "U S WEST")⁴ was part of a U S WEST general rate case. (App. Brief at 4). That is simply untrue. U S WEST's filing in the case (Case No. 90-049-03) was for the express purpose of seeking approval of a sharing plan. (R. 3739-60). U S WEST did not initiate a general rate case. It was the subsequent filing by the Division of Public Utilities (hereafter "Division") of a petition to investigate U S WEST's earnings (Case No. 90-049-06) that generated the general rate proceeding. (R. 4241-60). The two separate proceedings were then consolidated for hearing. (R. 3875-82).

Appellants' Statement leaves out large portions of the procedural history of the case, including descriptions of the comprehensive testimony filed with regard to U S WEST's and the Division's proposed sharing plans. However, the Commission's June 19, 1990 Report and Order sets forth a detailed procedural history (R. 5384-88). A copy of the Report and Order is attached as Addendum B. The order also describes in some detail the evidence presented by the parties (R. 5462-69, Addendum B). Rather than repeat that information here, Respondents refer the Court to the Commission's Order.

STATEMENT OF FACTS

Appellants' Statement of the Facts is not a review of the facts presented below. While it is 45 pages long, references to the record are minimal.⁵ In fact,

⁴ Respondent U S WEST Communications, Inc. should be distinguished from its parent, U S WEST, Inc., which is not a party to this case.

⁵ While Appellants make reference to the transcript and to other items in the record, they fail to cite the record in compliance with the requirements of Rule 24(e) of the Utah Rules of Appellate Procedure.

most of the 45 pages is dedicated to assertions and analysis that have nothing to do with the factual record below. For example:

1. Appellants assert that they were not treated fairly in the manner in which Section 54-4-4.1 was enacted by the Utah Legislature. (App. Brief at 11-12). Yet they cite nothing in the record to support their assertion and make no claim that the statute was not legally enacted.

2. Appellants relate their subjective conclusions about sharing plans in general, their perception that the statute lacks appropriate standards, and their subjective assessment of U S WEST's motivation in seeking an incentive plan. (*Id.* at 14-15). Yet none of the Appellants testified in the hearing nor did they present any expert testimony.

3. Appellants make unsupported assertions as to the market share of gas, electric and telephone utilities in Utah, all without benefit of citations to the record. (*Id.* at 15-16).

4. Appellants relate a variety of alleged procedural problems (*Id.* at 17-19), none of which serve as the basis for any of the substantive issues raised by Appellants on appeal. The only purpose for their recitations is to prejudice the case.

5. Appellants present a lengthy argument as to their view of the legal and economic underpinnings to utility regulation. (*Id.* at 20-40). In these twenty pages there are only two footnotes citing to the record.⁶

⁶ Appellants' legal and economic analysis in their fact section serves as the fundamental premise to their constitutional argument. Respondents address these issues in Section III, *infra*.

6. Appellants present a lengthy discussion of why, in their view, sharing plans are not valid (*Id.* at 40-50).

Appellants' limited references to the record below are not made for the purpose of presenting a balanced view of the comprehensive testimony presented on incentive regulation/sharing plans,⁷ but are obviously presented in an effort to prove a proposition that is no longer at issue in this case: whether sharing plans are good or bad. It is not at issue because the U S WEST and Division plans were rejected by the Commission (R. 5477, Addendum B), and U S WEST opted out of the Commission's plan. (R. 5692-93). Since no party in this case asserts that a sharing plan is in effect, the general merit of sharing plans is not an issue that this Court must determine. Thus, the only purpose of Appellants' demonization of sharing plans is to inject irrelevant and prejudicial information into the case so that the Court will be moved to accept Appellants' facial challenge to the constitutionality of Section 54-4-4.1.

A. **Incentive Regulation/Sharing Plans.** Thus, although Appellants' diatribe against sharing plans is technically irrelevant, it is nevertheless important for the Court to gain a greater understanding of sharing plans, based on the record below. Extensive testimony on sharing plans was presented by witnesses for U S WEST, the Division and the Committee of Consumer Services (Committee). The primary witnesses presented by U S WEST were Robert C. Fuehr (R. 7781-7801), Utah Vice President, Kirk R. Nelson (R. 7803-7981), Assistant Vice

⁷ The terms "incentive regulation" and "sharing plans" are synonymous and are used interchangeably in this Brief.

President, Dr. William H. Davidson (R. 7982-8099), Associate Professor of Management at the University of Southern California, and Phillip S. Selander (R. 8100-8225), Director-Network Facilities Engineering. The general position of U S WEST was that a properly constructed sharing plan would create positive benefits to the utility, its customers and to the state in general. The Division presented the testimony of five of its staff members: Dr. George Compton (R. 7072-7159), Thomas F. Peel (R. 6745-6884), Larry F. Fuller (R. 6924-92), Earl Brown (R. 6887-6923) and Ingo Henningsen (R. 6993-7019). The Division, while less ebullient about sharing plans than U S WEST, concluded that a plan could be constructed that could result in lower rates for customers over traditional regulation and felt that a plan that could be reviewed within 3 years was worth the experiment. The Committee presented the testimony of two outside consultants: William W. Dunkel (R. 6082-6561) and Michael L. Arndt (R. 6060-81). The Committee witnesses were generally opposed to sharing plans, preferring traditional rate of return regulation. Appellants presented no testimony.

Earnings sharing plans represent a recent trend in the regulation of telephone utilities in the United States. While no two plans are identical, there are two features that are common to most plans:

1. **Some form of rate freeze on essential services for a specified period of time (usually 3 to 5 years).** Thus, in most plans the utility gives up its right to initiate a rate case for the term of the plan. (R. 7987, 8000)
2. **Some form of retroactive sharing of profits above a predetermined level.** Thus, an inherent part of any plan includes the utility's

consent to some form of retroactive refunds to customers. (R. 7816-8307)

In addition to those items, plans often include service standards, service improvement requirements, infrastructure upgrades, and other features designed to protect ratepayers and to provide incentive to the utility to be more efficient, service conscious, and responsive to customer desires for new services.

U S WEST's witnesses presented several reasons why an appropriately structured incentive regulation plan was in the public interest:

- Incentive regulation focuses on beneficially harnessing profits rather than limiting them, thus producing incentives that traditional regulation is not equipped to provide. (R. 7808-09, 7815, 7987-89).

- Incentive regulation explicitly uses market forces (rather than regulatory mandates) to guide the deployment of new technology investments, while continuing to sustain universal service. (R. 7834, 7878-82).

- Incentive regulation encourages beneficial behaviors and the achievement of regulatory goals in ways that traditional regulation cannot.⁸ (R. 7809-10, 7813-17, 7819-21, 7984-90, 8002-8010). Specifically, under traditional regulation U S WEST does not benefit from significant improvements in efficiencies and marketing success since, through the rate process, advances in these areas ultimately are flowed back 100% to

⁸ Many other jurisdictions have moved away from traditional regulation in recent years. In the last few years, three states have adopted a form of deregulation, six have adopted rate caps, and 18 have adopted incentive regulation (R. 7866).

ratepayers. (R. 8037-47, 8083-89).

- . Incentive regulation would enable Utah to compete more effectively with other states in attracting new telecommunications investments and services. This will occur sooner and in greater quantity than without improved regulation. (R. 7808-12, 7815, 8031-33, 8036). It also provides financial benefits that recognize increased risks for both customers and U S WEST associated with new technologies and greater competition (both among states and among companies). (R. 7815). It will therefore enhance economic development in Utah. (R. 7787-93, 7796-99, 7838, 7987-89, 7991-92, 7998-8001, 8008-10).

- . Incentive regulation allows customers to share financially in improvements triggered by the added incentives, in addition to the benefits that will be derived from new services. (R. 7838).

- . Incentive regulation encourages quality service, efficient operations, prudent capital investments, new services and revenue growth without rate increases. (R. 7808-14).

- . Incentive regulation protects customers from rate increases in an environment in which rate reductions cannot be expected to continue, while providing extensive modernizations. (R. 7295, 7297-99, 7301-02, 7809, 7823).

While the Division characterized incentive regulation as an experiment (R. 6748), it recognized that there is always room for improvement in the management process and that it would be difficult to know the benefits of incentive regulation unless it is actually tried. (R. 6752). Potential benefits include "addi-

tional sharable earnings benefitting both the ratepayer and shareholder along with the more rapid deployment of new technology" and the reduction of regulatory costs by eliminating contested rate cases. (R. 6753-55). It also provides opportunities for refunds relating to prior periods, provides incentive to create and market new services, and expedites the replacement of older technologies. (R. 6755). In addition to this qualitative testimony, Dr. Compton of the Division presented a study in support of the Division's plan that quantitatively estimated regulatory lag and other factors so that a plan could be developed that would assure that ratepayers benefit from it. (R. 7073-7148).

The Committee opposed the concept of incentive regulation, making three basic assertions: (1) the continuous lowering of rates is the norm in the telecommunications industry – thus, incentive regulation is unnecessary (R. 6090-91); (2) incentive regulation creates a disincentive for investment, while traditional regulation promotes investment (R. 6142, 6150-59); and (3) utility employees already have adequate incentives under traditional regulation (R. 6248).

In its Order, the Commission agreed with some of the propositions asserted by the parties and disagreed with others (R. 5470-78), ultimately rejecting the specific plans offered by U S WEST and the Division (R. 5477) and adopting a plan of its own. Although rates were frozen and the Commission plan was designed to last five years, the Commission reserved the power to "terminate the plan at any time if it is convinced that the public interest justifies termination." (R. 5478-79). It also contained provisions requiring the retroactive sharing of profits above certain levels (R. 5479).

While there was a voluminous record dealing with the claimed merits and asserted problems with incentive regulation, one of the underlying premises of Appellants' so-called fact statement is an inference that the plans presented by U S WEST and the Division, as well as the plan adopted by the Commission, represent drastic and reckless departures from the mainstream. Appellants, for example, spend considerable energy in pointing out that incentive regulation is not beneficial to the public and that the Commission should not have adopted any kind of plan. The fact of the matter, however, is that sharing plans have been adopted in many different state jurisdictions and that virtually every plan adopted provides the utility with far greater opportunity for earning than would the Commission plan.

At various points in the proceeding, parties presented updates as to the status of sharing plans in other jurisdictions.⁹ The final exhibit presented was U S WEST Exhibit 10R.4 (R. 8307, Addendum C), which summarized major elements of plans approved in 16 jurisdictions. A review of that exhibit demonstrates that the plans proposed by U S WEST and the Division were well within the mainstream of plans adopted elsewhere and that the plan adopted by the Commission, while containing elements similar to those other plans, is more restrictive to the utility than other plans. The Commission plan would have allowed U S

⁹ The Division witness Thomas Peel presented a summary of plans in other states. (R. 6876-84).

WEST to earn a maximum return on equity of 14%.¹⁰ The authorized return on equity established by the Commission was 12.2%. By contrast, for the plans in the other 16 jurisdictions, the average authorized return was 13.13% and the point at which sharing commenced was 13.94%, only .06% below the absolute maximum earnings that U S WEST could achieve under the Commission plan. (R. 8307, Addendum C). Thus, Appellants' inference that the incentive plans proposed below were a major departure (to the detriment of ratepayers) from the mainstream simply is not supported by the evidence.

B. Rate of Return. Appellants assert that the Commission's finding of a 12.2% return on equity is not supported by substantial evidence. In responding to that claim, in Section VIII, *infra*, Respondents review portions of the evidence presented that support that finding. Since that evidence is reviewed in Section VIII, it will not be repeated here.

SUMMARY OF THE ARGUMENT

1. Whatever the Court decides in this case, no sharing plan is in effect or will go into effect. Therefore, with the exception of the rate of return issue, all issues raised by Appellants in their appeal are moot. This Court has adopted a

¹⁰ The Commission plan (R. 5479, Addendum B) worked this way:

	<u>Ratepayer Share</u>	<u>Company</u>	<u>Total Company</u>
Up to 12.2%	0	all	12.2
12.2 to 13.2%	80%	20%	.2
13.2 to 14.2%	60%	40%	.4
14.2 to 17.0%	50%	50%	1.4
over 17%	all	0	<u>0.0</u>
Maximum Company Earnings			<u>14.0%</u>

strong policy of avoiding decisions on constitutional issues unless essential to decide a case. Under this doctrine, the challenger must demonstrate that he or she is being adversely affected by the statute. Since Appellants cannot make such a demonstration regarding Section 54-4-4.1, their constitutional claims are moot. Further, this Court has adopted a strong policy against rendering advisory opinions, which is precisely what Appellants are seeking. Finally, the facts of this case do not bring it within the only exception to the mootness doctrine adopted by this Court.

2. When a party challenges the constitutionality of a statute, the burden rests heavily on the party making the challenge. That burden is particularly heavy when the statute being challenged deals with economic matters. This Court presumes statutes to be valid; when faced with two different interpretations of a statute, the Court will choose the interpretation that validates the statute.

3. Neither the Constitution nor the Public Utility Code requires cost of service regulation as the only method that can be utilized by the Commission in establishing "just and reasonable" rates. The Public Utility Code only requires that rates be "just and reasonable," but does not define for the Commission how it should reach "just and reasonable" rates. Instead, the statutes set forth broad policy statements to guide the Commission in setting rates. Section 54-4-4.1(1) merely codifies for the Commission that it is free to adopt any method or formula of rate regulation consistent with Title 54. The courts have held that it is the final impact of the rate order that determines if the action of the Commission is constitutional. As long as the rates are not confiscatory and procedural due

process has been followed, constitutional requirements have been met. The Commission is free to adopt other methods or formulas to achieve "just and reasonable" rates and courts will not interfere with their choice. The Commission establishes rates; rate of return is only one of the elements that goes into the formula for setting rates. Those rates remain in effect until new rates are set by the Commission. If the rates produce revenue that results in a return lower than what was authorized by the Commission, the utility cannot make up the difference retroactively. Likewise, if the utility earns more than the rate of return authorized by the Commission, the utility keeps the difference until new rates are established. Therefore, rates that have been found "just and reasonable" by the Commission do not become "unjust and unreasonable" automatically when earnings are either above or below the return authorized by the Commission in the utility's last rate case.

4. (a) Section 54-4-4.1 does not violate Article VI, Section 1 of the Utah Constitution by unconstitutionally delegating legislative powers to the Commission. Rate making is clearly the type of function that can be delegated to an administrative agency such as the Commission. Courts have held that the broad standards contained in the Public Utility Code are sufficient to guide the Commission in establishing rates. In addition, sufficient procedural safeguards are contained in the Public Utility Code and the Administrative Procedures Act to ensure that due process is met.

(b) Section 54-4-4.1 does not violate Article V, Section 1 of the Utah Constitution by delegating powers to the Courts to select a different method of rate

regulation than that chosen by the Commission. In reviewing orders of the Commission, Courts will not substitute their judgment for that of the Commission. The Court has never had nor ever asserted the power to establish a rate regulation different from the Commission and thus no authority to establish rates has been delegated to the Courts.

(c) Section 54-4-4.1 does not violate Article I, Section 7 of the Utah Constitution. Adequate standards are included within the Public Utility Code to comply with due process. In addition, sufficient procedural safeguards are included within the Public Utility Code and the Administrative Procedures Act in order to satisfy due process. Finally, Section 54-4-4.1 is not so vague as to run counter to due process.

(d) Section 54-4-4.1 does not violate state antitrust policies, including Article XII, Section 20 of the Utah Constitution. In fact, state antitrust policies envision that regulation of public utilities does not generally fall under state antitrust statutes.

5. Subsection 2 of Section 54-4-4.1, which allows a public utility to elect not to proceed with a revenue sharing plan (i.e. requires utility consent to a Commission-adopted revenue sharing plan) is neither an unconstitutional delegation of legislative power, nor a deprivation of Appellants' due process rights. There is no improper delegation, because the statute merely recognizes the common law and constitutionally-based rule against retroactive rate making, under which a utility could prohibit "revenue sharing" regardless of the existence of Subsection 2. Furthermore, the grant of a consent power to a private party is

generally valid where it requires consent to waive a restriction, such as in the statute in question. The granting of a veto power to public utilities over revenue sharing plans, while other parties have no such power, does not violate due process principles, because the public utility is in a unique position in a rate proceeding, since only its earned revenue is at risk, and no other party has the right or incentive to invoke the rule against retroactive rate making.

6. The Court need not rule on the severability issue since no party claims that a sharing plan can go into effect in this case. Nevertheless, in the event the Court addresses the severability issue, since Subsection 1 is broader than Subsection 2, the possible invalidation of Subsection 2 should not invalidate Subsection 1.

7. Appellant's request for costs and attorney's fees was raised for the first time on appeal. Neither of the two theories upon which Appellants base their request—the "substantial benefits" rule or the "private attorney general" doctrine—has been adopted by this Court; rather this Court follows the general rule that attorney's fees are awarded only where allowed by statute or contract. Even if the Court were to adopt the substantial benefits test, Appellants' claim clearly fails to meet the test. The private attorney general doctrine has been rejected by the United States Supreme Court and by the majority of state courts that have addressed it on the ground that the doctrine is an impermissible judicial entry into the province of the legislative branch. Nevertheless, even if the Court were to adopt the private attorney general doctrine, Appellants' claim does not meet the test. Finally, Appellants' attorney's fees claim is procedurally and factually

flawed and, if granted, would violate U S WEST's due process rights.

8. Appellants have the burden of establishing that the Commission's finding of a 12.2% return on equity was not based on substantial evidence. Furthermore, it is Appellants' duty to marshal the evidence supporting the finding, otherwise the finding is accepted as conclusive. Appellants failed to marshal the evidence. In any event, it is clear from the record that the finding is based on substantial evidence.

ARGUMENT

I. APPELLANTS' APPEAL RELATING TO THE CONSTITUTIONALITY OF SECTION 54-4-4.1 AND ATTORNEYS' FEES IS MOOT.

A. There is no earnings sharing plan in effect.

The inescapable and uncontested fact is that no alternative method of regulation under Section 54-4-4.1 presently exists or can exist for U S WEST in Utah, unless and until one is adopted in a future proceeding before the Commission. U S WEST and the Division proposed plans that were rejected by the Commission. (R. 5477, Addendum B). Instead, the Commission adopted a plan of its own (R. 5478-80), which U S WEST rejected under Section 54-4-4.1(2) (R. 5692-93). Thus, Appellants' goal, which is that traditional regulation remain in effect, continues to be fully achieved. No party is challenging that result on appeal.¹¹ Thus, although Appellants seek to challenge the constitutionality of Section 54-4-

¹¹ While U S WEST, in its Petition for Rehearing, asked the Commission to reconsider its decision on the earnings sharing plan and adopt a plan more in line with the one it proposed, U S WEST has not appealed the Commission's decision not to do so. Likewise, the Division has not appealed the denial of its plan.

4.1, a determination of that issue would not affect the current means by which U S WEST is regulated.

B. A declaration of unconstitutionality of Section 54-4-4.1 would not affect the status quo, because the current rate order was issued under traditional cost-of-service ratemaking procedures.

On the one hand, Appellants attack U S WEST's exercise of the statutory right to opt out of a sharing plan, claiming the existence of such a right is unconstitutional. However, they do not do so in order to allow the Commission's sharing plan to go into effect, because they also claim that the Commission does not have the constitutional right to adopt a non-traditional method of regulation and that the Commission's plan should be declared invalid. Their argument, if adopted, would therefore lead directly back to the status quo, because traditional regulation is presently in effect.

No party asserts that any kind of plan under Section 54-4-4.1 is currently in effect. As a consequence, whether Appellants' constitutional claims prevail or not, the requested relief would not alter the rate order that now governs their telephone service. Thus, all issues raised in Appellants' Docketing Statement and Brief, with the exception of the issue relating to return on equity, are moot and need not be decided by this Court.

C. The Court should not determine the constitutionality of a statute unless it is essential to decide the case.

With the exception of the rate of return issue, the issues raised by Appellants go in various ways to the constitutionality of Section 54-4-4.1. In a long line of cases, this Court has established the firm principle that it will avoid, where possible, pronouncements as to the constitutionality of state statutes. The leading

case on this issue is Hoyle v. Monson, 606 P.2d 240 (Utah 1980). In Hoyle, the Court outlined some basic principles:

The right and power of the judiciary to declare whether legislative enactments exceed constitutional limitations is to be exercised with considerable restraint and in conformity with fundamental rules. **One such fundamental rule of long-standing is that unnecessary decisions are to be avoided and that the courts should pass upon the constitutionality of a statute only when such a determination is essential to the decision in a case.** A constitutional question does not arise merely because it is raised and a decision is sought thereon; rather, the constitutionality of a statute is to be considered in the light of the standing of the one who seeks to raise the question and of its particular application. An attack on the validity of a statute cannot be made by parties whose interests have not been, and are not about to be, prejudiced by the operation of the statute.

Hoyle, 606 P.2d at 242 (footnotes omitted, emphasis added). See State v. Rio Vista Oil, Ltd., 786 P.2d 1343, 1349 (Utah 1990) (“[a] fundamental principle of judicial review is that, when possible, we refrain from deciding constitutional questions”); State v. Anderson, 701 P.2d 1099, 1103 (Utah 1985). Thus, this Court has adopted a fundamental principle of judicial restraint on constitutional questions. Given the fact that no earnings sharing plan is in effect, or could go into effect if Appellants prevailed, it is not “essential” for the Court to determine the constitutionality of Section 54-4-4.1 in this case.

D. The constitutionality of a statute may only be attacked when the challenger is adversely affected by the statute's application.

Other cases state that in order for a party to have standing to attack the constitutionality of a statute, the statute must be in the process of being applied to

the disadvantage of that party or there must be an immediate threat of its application:

The constitutionality of a statute is to be considered in the light of the standing of the party who seeks to raise the question and of its particular application; and a person may challenge the constitutionality of a statute **only when and as far as it is being, or is about to be applied to his disadvantage.**

Cavaness v. Cox, 598 P.2d 349, 351-52 (Utah 1979) (emphasis added). In Sims v. Smith, 571 P.2d 586 (Utah 1977), the Court stated that "before a party may attack the constitutionality of a statute he must be adversely affected by that very statute." 571 P.2d at 587, *quoting* Pride Club v. State, 481 P.2d 669 (Utah 1971). In Duran v. Morris, 635 P.2d 43, 45 (Utah 1981), this Court stated that "[i]f the requested judicial relief cannot affect the rights of the litigants, the case is moot and a court will normally refrain from adjudicating it on the merits." *Accord*, Black v. Alpha Financial Corp., 656 P.2d 409, 411 (Utah 1982); Merhish v. H.A. Folsom & Associates, 646 P.2d 731, 732 (Utah 1982); State v. Kallas, 94 P.2d 414, 424 (Utah 1939).

It is undisputed that no plan of any kind is now in effect under the powers granted to the Commission by Section 54-4-4.1. Indeed, U S WEST continues to be regulated under the traditional regulatory regime that Appellants assert is desirable and legally required. No possible outcome of Appellants' appeal would change that fact. Furthermore, while U S WEST has appealed the Commission's June 19, 1991 order, none of the issues raised by it go either to the Commission's refusal to adopt its proposed plan or to the plan adopted by the Commission that U S WEST elected not to accept. Appellants' interest in retaining traditional regulation of U S WEST in Utah will not be affected in any way by a decision on the

constitutionality of Section 54-4-4.1. Therefore, Appellants' appeal on those constitutional issues should be dismissed.

E. **The Court should not render advisory opinions, even on a request for declaratory judgment.**

After articulating its policy of restraint in dealing with constitutional issues, this Court in Hoyle set forth its strong policies relating to advisory opinions and mootness:

A further fundamental rule is that the courts do not busy themselves with advisory opinions, nor is it within their province to exercise the delicate power of pronouncing a statute unconstitutional in abstract, hypothetical, or otherwise moot cases. It has been found to be far wiser, and it has become settled as a general principle, that a constitutional question is not to be reached if the merits of the case in hand may be fairly determined on other than constitutional issues.

606 P.2d at 242 (footnote omitted, emphasis added). Other cases have reiterated the strong policy against rendering advisory opinions:

Because of a longstanding judicial policy in Utah to avoid advisory opinions, we do not generally consider mooted questions on appeal . . . "The function of appellate courts, like that of courts generally, is not to give opinions on merely abstract or theoretical matters, **but only to decide actual controversies injuriously affecting the rights of some party to the litigation**, and it has been held that questions or cases which have become moot or academic are not a proper subject to review."

Reynolds v. Reynolds, 788 P.2d 1044, 1045 (Utah App. 1990), *quoting* MacRae v. Jackson, 526 P.2d 1190, 1191 (Utah 1974). *Accord*, Black, 656 P.2d at 410-11; Merhish, 646 P.2d at 731; Spain v. Stewart, 639 P.2d 166 (Utah 1981). In State v. Stromquist, 639 P.2d 171, 172 (Utah 1981), the Court made it clear that the test whether a statute affects the legal right of a litigant is to be made in the context of the current case, not some hypothetical future case:

The defendant's abortive appeal to this Court can and does request only an opinion of this Court as to the validity of a statute in which the defendant has no further interest as it applies to the history of *this* case. This Court was not intended to be, nor is it endowed with authority to render advisory opinions, and has said so many times.

(italics in original). No current rights of any party, including those of the Appellants, can possibly be impacted in this case by a determination of constitutionality of Section 54-4-4.1. Thus, Appellants' effort to secure an advisory opinion from this Court should be denied.

The principles enunciated above are equally applicable to Declaratory Judgment Actions under Section 78-33-2. The Utah Declaratory Judgment Act, Sections 78-33-1 *et seq.*, provides a means by which litigants can seek a judicial declaration of their rights under statutes. Section 78-33-2 states:

Any person interested under a deed, will or written contract, or whose rights, status or other legal relations are affected by a statute, municipal ordinance, contract or franchise, may have determined any questions of construction or validity arising under the instrument, statute, ordinance, contract or franchise and obtain a declaration of rights, status or other legal relations thereunder.

This Court has held that actions under the Act are subject to the same limitations discussed in prior sections of this memorandum. For example, in Baird v. State, 574 P.2d 713 (Utah 1978), the plaintiff sought and received a declaratory judgment that a portion of the Occupational Safety and Health Act was unconstitutional. On appeal, this Court reversed, ruling that the district court should have held that "it lacked jurisdiction to render an advisory opinion." 574 P.2d at 715. The Court's discussion is highly instructive. It first noted that plaintiff had pleaded no "concrete facts indicating any specific injury sustained or threatened to plaintiff personally." 574 P.2d at 715. Then, citing Lyon v. Bateman, 228 P.2d 818

(Utah 1951), the Court stated:

In *Lyon v. Bateman*, this Court stated that while statutes authorizing courts to render declaratory relief should be liberally construed, the courts must, nevertheless, operate within the constitutional and statutory powers and duties imposed upon them. The courts are not a forum for hearing academic contentions or rendering advisory opinions. To maintain an action for declaratory relief, plaintiff must show that the justiciable and jurisdictional elements requisite in ordinary actions are present, for a judgment can be rendered only in a real controversy between adverse parties.

. . . Generally, courts have held that the conditions which must exist before a declaratory judgment action can be maintained are: (1) a justiciable controversy; (2) the interests of the parties must be adverse; (3) the party seeking such relief must have a legally protectible interest in the controversy; and (4) the issues between the parties involved must be ripe for judicial determination.

To entertain an action for declaratory relief, there must be a justiciable controversy, for the courts do not give advisory opinions upon abstract questions. The use of the term "rights, status and other legal relations" in the declaratory judgment statute (§ 78-33-2, U.C.A. 1953) relates to a justiciable controversy where there is an actual conflict between interested parties asserting adverse claims on an accrued state of facts as opposed to a hypothetical state of facts.

Baird, 574 P.2d at 717, quoting Lyon, 228 P.2d at 820; Backman v. Salt Lake County, 375 P.2d 756 (Utah 1962). The Baird court also made it clear that in order to determine the legal validity of a statute, the party must show a direct injury resulting from the statute:

To invoke judicial power to determine the validity of executive or legislative action, **claimant must show that he has sustained or is immediately in danger of sustaining a direct injury as a result of that action.** It is insufficient to assert a general interest he shares in common with all members of the public, viz., a generalized grievance.

Baird, 574 P.2d at 717 (emphasis added).¹²

While Appellants did not proceed under the Declaratory Judgment Act, its principles are applicable to their claim. Since Appellants' claims for review in their appeal would fail under the Declaratory Judgment Act, Appellants are inappropriately attempting to do indirectly what they would not be allowed to do under the Declaratory Judgment Act. They are, in effect, attempting to obtain a declaration from the Supreme Court that they would have been unable to obtain from the District Court.

A reading of Appellants' Docketing Statement and Brief shows that they are adamantly opposed to sharing plans in general and that they believe such plans are harmful to ratepayers (App. Brief at 40-52). Yet, nowhere do they acknowledge the obvious fact that no such plan is or has been in effect in Utah, nor the fact that U S WEST remains subject to the kind of traditional regulatory treatment Appellants believe is required. This Court can grant no specific relief in this case that will change the fact that U S WEST is currently subject to traditional regulation. Furthermore, in Appellants' own words, they are "customers of U.S. West." (*Id.* at 5). They claim no other status.¹³ Other than the possibility that U S WEST

¹² The Court also quoted with approval the following statement from 1 Anderson, *Declaratory Judgments*, 2d ed. § 9, at 49-50:

A justiciable controversy authorizing entry of a declaratory judgment is one wherein the plaintiff is possessed of a protectible interest at law or in equity and the right to a judgment, **and the judgment, when pronounced, must be such as would give specific relief.** (emphasis added).

¹³ As pointed out in footnote 48, *infra*, Appellants intervened in their own behalf and not as representatives of a broader class.

or some other utility may seek an earnings sharing plan in a future case that may affect Appellants as utility customers, they have no present interest that can be affected by this case. Thus, Appellants have not shown that they have sustained any direct injury from the operation of Section 54-4-4.1, nor can they show that they are "immediately in danger of sustaining" such an injury. Their appeal is therefore moot and should be dismissed.

F. **This case does not fall within the only exception to the mootness doctrine.**

The Utah Supreme Court, in Wickham v. Fisher, 629 P.2d 896 (Utah 1981), adopted a limited exception to the basic principle that it will not rule on moot issues. In Wickham, a former pretrial detainee filed a writ of habeas corpus challenging the constitutionality of certain aspects of the jail conditions while he was detained. On appeal, the defendants contended that plaintiff had no standing since he was no longer a pretrial detainee. This Court held that, while the case was technically moot, it fell within the following limited exception:

The principles that determine the justiciability of the instant case are the well-established rules which permit a court to litigate an issue which, although technically moot as to a particular litigant at the time of appeal, is of wide concern, affects the public interest, is likely to recur in a similar manner, **and, because of the brief time any one person is affected, would otherwise likely escape judicial review.**

629 P.2d at 899 (citations omitted, emphasis added). The Court cited as models for the exception cases like Roe v. Wade, 410 U.S. 113 (1973) where, because of the short human gestation period, the pregnancy would come to term before the appellate process could be completed. Thus, in light of the fact that "present and future detainees will suffer conditions at the jail for a period of time insufficient

for a case to receive appellate review during the imposition of such conditions” the Wickham Court held that it reflected “a continuing and recurring controversy sufficient to invoke the jurisdiction of this Court.” 629 P.2d at 900.

This exception has been discussed in four subsequent cases, and in none of them did the Court invoke the exception. In Merhish, this Court made it clear that the exception applies only in extremely limited circumstances:

The **extraordinary circumstances** that occasionally provide an exception to the mootness rule . . . are clearly absent in this case.

646 P.2d at 732 (emphasis added).

In State v. Davis, 721 P.2d 894 (Utah 1986), a criminal defendant asked this Court to declare invalid a sentencing order that prescribed his criminal punishment. Despite the fact that the defendant had served his sentence and received a termination of probation, he asked that the issue be considered under the exception to the mootness rule. This Court described the exception this way:

The exception alluded to is where there is a continuing and recurring controversy but, **because of the short period for adjudication**, appellate review of the issue is effectively denied.

Davis, 721 P.2d at 895 (emphasis added). The Court held that the case did not fall within the exception and refused to address the issue.

In Burkett v. Schewendiman, 773 P.2d 42 (Utah 1989), a motorist challenged a driver’s license revocation proceeding. Burkett’s license was revoked for failing to submit to a blood alcohol test. On appeal, he asked that the revocation be reversed despite the fact that the one year period had already passed. The Court noted that it occasionally invokes an exception to the mootness doctrine “when the case presents an issue that affects the public interest, is likely to recur, **and**

because of the brief time that any one litigant is affected, is capable of evading review.” 773 P.2d at 44 (emphasis added). The Court concluded that the case was not an appropriate one in which to invoke the exception.

Finally, in Salt Lake City v. Tax Commission, 813 P.2d 1174 (Utah 1991), the Court reaffirmed the exception but held that, because of a subsequent legislative change, the issue in the case was unlikely to recur and was therefore moot.

In order to meet the terms of the exception, all of the following requirements must be met:

1. It must be a public issue of wide concern;
2. It must be an issue likely to recur; and
3. Because of the brief time any one litigant is affected, the issue is likely to evade review.

As a threshold matter, the third element cannot be met in this case because no earnings sharing plan has ever affected Appellants in Utah. The legal authorities require that in order to challenge the constitutionality of a statute, the rights or interests of the party making the challenge must have been affected (or there must be an imminent threat of such an effect). In Wickham, the only case where this Court has actually applied the exception, the plaintiff had actually been affected by the jail conditions while he was a pretrial detainee. Likewise, in Roe v. Wade, the plaintiff had been directly impacted by the restrictions of the abortion law being challenged. In contrast, the only thing that has occurred in this case was the consideration of earnings sharing plans under Section 54-4-4.1—the result, however, was that no plan became effective and the status quo (the

traditional regulation of U S WEST) has not changed. Thus, Appellants cannot meet the basic threshold requirement to even allow consideration of the exception to the mootness rule.

Even if Appellants were affected by an earnings sharing plan, they do not meet the other elements of the exception on the specific issues they raise in their Brief.

Points I and II. In Point I, Appellants assert that the opt out provision, Section 54-4-4.1(2), is unconstitutional. (App. Brief at 59-67). In Point II, Appellants assert that if subsection 2 is unconstitutional, then all of Section 54-4-4.1 is unconstitutional since, in their view, subsections 1 and 2 are not severable. (App. Brief at 67-69). There is no basis to conclude that the issue will be likely to recur in the manner it has in this case or that it will evade review. It is entirely possible that the Commission could in the future adopt an earnings sharing plan (either of its own making or proposed by another party) that the public utility will reject, but which the Commission or some other party feels should be required regardless of the attempt by the utility to reject the plan. If the Commission were to order such a plan despite the utility's effort to reject it, both the constitutionality of subsection 2 and its severability from subsection 1 would be at issue.

Point III. Appellants argue that subsection 1 of Section 54.4.4.1—the basic provision allowing the Commission to adopt alternative methods of regulation—is unconstitutional for a variety of reasons. (App. Brief at 67-69). There is no basis to conclude that the constitutionality of the subsection will evade review. In the event the Commission adopts an alternative form of regulation under Section 54-4-

4.1(1) in a future case and the utility accepts it, then the issue will be squarely faced, either on appeal or at the District Court under the Declaratory Judgment Act. Thus, there is no basis to conclude that the constitutionality of Section 54-4-4.1(1) will evade review.

Point IV. In Point IV, Appellants claim that the plan adopted by the Commission is invalid because its adoption was procedurally flawed. (App. Brief at 97-101). Yet the plan adopted by the Commission is not in effect. Further, since there is no reason to believe that that precise plan will again be adopted in a future case, this is not an issue that will likely recur, nor is there any basis to conclude that it will evade review. If, in the future, an earnings sharing plan becomes effective, it is that plan that should be reviewed. Since a review of the Commission plan is purely hypothetical, it is obviously a moot issue.

Point VI. In Point VI, Appellants assert that they are entitled to attorney's fees and costs associated with challenging the constitutionality of Section 54-4-4.1. (App. Brief at 105-18). Since this issue is entirely derivative of the constitutional question in Points I through IV, it should be dismissed along with them. It should also be dismissed on the additional grounds set forth in Section VII, *infra*.

G. Summary.

This Court has adopted a strong policy against making a determination of the constitutional validity of state statutes, except where "such determination is essential to the decision in the case."¹⁴ Likewise, this Court has consistently held that a person has standing to challenge the constitutionality of a statute only

¹⁴ Hoyle, 606 P.2d at 242.

where the statute is being applied “or is about to be applied to his disadvantage.”¹⁵ It is undisputed that the determination of the constitutionality of Section 54-4-4.1 is not essential to the decision in any case—it is equally undisputed that the statute is not currently being applied to Appellants’ detriment, nor is it about to be. Further, this Court has adopted a strong policy against rendering advisory opinions, which is precisely what Appellants are requesting this Court to do. Appellants are asking this Court to render a decision that they would be unable to obtain from a District Court under the Declaratory Judgment Act. Finally, none of the issues raised by Appellants fall within the single limited exception to the mootness doctrine adopted by this Court.

On this basis, Respondents respectfully request that this Court dismiss on mootness grounds all issues except the rate of return issue.

II. THE COURT SHOULD FOLLOW GENERALLY ACCEPTED RULES OF STATUTORY CONSTRUCTION IN INTERPRETING THE VALIDITY OF SECTION 54-4-4.1.

This section and the remaining sections of the Brief, with the exception of Sections VII and VIII, address issues relating to the constitutionality of Section 54-4-4.1 and are only relevant if the Court declines to rule that those issues are moot.

Prior to discussing the constitutionality of Section 54-4-4.1, it is essential to review generally accepted rules of statutory construction used by the Court in determining the constitutionality of statutes.

In Utah Associated Municipal Power Systems v. Public Serv. Comm’n, 789

¹⁵ Cavaness, 598 P.2d at 352.

P.2d 298, 301 (Utah 1990), this Court declared that statutes are presumed to be constitutional:

We first note the presumption of validity accorded legislative enactments when attacked on constitutional grounds. The burden is on those who would have us strike down the statute.

In State v. Rio Vista Oil Ltd., 786 P.2d 1343, 1349-50 (Utah 1990), this Court reaffirmed these basic constitutional principles and stated:

It is axiomatic that statutes are presumed to be constitutional and that the party challenging a statute's constitutionality bears the burden of proving that it is invalid. This burden is especially heavy when attacking an economic measure. [citations omitted]

In Utah Technology Finance Corp. v. Wilkinson, 723 P.2d 406, 412-13 (Utah 1986), this Court stated:

"Due respect for the legislative prerogative in law making requires that the judiciary not interfere with enactments of the Legislature where disagreement is founded only on policy considerations and the legislative scheme employs reasonable means to effectuate a legitimate objective." [quoting Baker v. Matheson, 607 P.2d 233 (Utah 1979)] It is only when a legislative determination of public purpose is so clearly in error as to be capricious and arbitrary that the judiciary should upset it. . . .

In Kent Club v. Toronto, 305 P.2d 870, 873-74 (Utah 1957), the Court held that legislation

should not be judicially declared invalid on the ground that it is unintelligible or uncertain unless it is so imperfect and deficient as to render it susceptible of no reasonable construction that will give it effect, or the court finds itself unable to divine the purpose and intent of the Legislature.

In Norville v. State Tax Commission, 97 P.2d 937, 939 (Utah 1940), the Court held:

Statutes duly enacted by the legislature are presumed to be constitutional and valid. When there is ambiguity in the terms of a statute or

when it is susceptible of two interpretations one of which would render it unconstitutional and the other bring it within constitutional sanctions, the court is bound to choose that interpretation which would uphold the statute, and to pronounce a statute unconstitutional only when the case is so clear as to be free from doubt. [citation omitted]

See also, Mountain States Telephone & Telegraph Co. v. Garfield County, 811 P.2d 184, 187 (Utah 1991).

The burden on Appellants in this case—to demonstrate that Section 54-4-4.1 is unconstitutional—is especially heavy because statutes relating to utility rate making are clearly economic measures. The rates charged by a public utility have an enormous impact on the citizens of Utah and the state's economic well-being. Under these circumstances, the Court should particularly strive to interpret Section 54-4-4.1 as a valid statute, even if it believes that there are two reasonable interpretations, one that would render the statute unconstitutional, and one that would make it valid.

III. NEITHER THE CONSTITUTION NOR THE PUBLIC UTILITY CODE MANDATES COST-OF-SERVICE RATE REGULATION AS THE ONLY PERMISSIBLE MEANS OF ESTABLISHING JUST AND REASONABLE RATES.

The central premise underlying all of Appellants' arguments is that traditional cost of service rate regulation is the only method of rate regulation authorized or permitted for natural monopoly public utilities.¹⁶ (App. Brief at 20-

¹⁶ Appellants' assumption that telephone companies are natural monopolies is subject to significant controversy before regulatory bodies throughout the nation, given the tremendous changes that are taking place in the telecommunications industry. However, even assuming telephone companies are natural monopolies, Appellants' arguments are unpersuasive. Therefore, this brief will not address this issue.

33). Furthermore, their argument relies upon a corollary premise that under traditional cost of service rate regulation, the authorized rate of return used by the Commission is an absolute constraint on utility earnings, such that earnings that exceed that rate of return are presumed illegal. Neither of these premises finds any support in any section of the Public Utility Code (Title 54), the Utah or United States Constitutions, or fundamental principles of rate making.

This section of Respondents' Brief will demonstrate that the Commission is bound to follow broad policy statements in the Public Utility Code, but is not required to achieve just and reasonable rates through any particular means. In particular, the objectives of a sharing plan are to encourage more efficiency in the utility than would otherwise occur under traditional regulation, by providing the utility an incentive to earn a return higher than it would under traditional regulation, but requiring the utility to share a portion of that higher return with its customers. Thus both the utility and the customer could be better off under "incentive" regulation than under traditional regulation. However, regardless of the merits of the debate over such forms of regulation, neither the Public Utility Code nor the Constitution prohibit an attempt to achieve these objectives by altering traditional regulation.

A. The Public Utility Code authorizes the Commission to set just and reasonable rates, but does not require the Commission to utilize any particular method in doing so.

The Public Utility Code requires that utility rates shall be "just and reasonable" and provides general guidelines as to what that phrase means. However, it does not specify any particular method or formula to be utilized in setting just and

reasonable rates.

Section 54-3-1 states that rates must be just and reasonable and suggests some criteria that may be reviewed in determining whether or not they are. It does not establish any method for setting rates.¹⁷

Section 54-4-4(1) also provides that the Commission must set just, reasonable, non-discriminatory, and sufficient rates and sets forth procedural prerequisites including the necessity of a hearing and an order. However, the method of setting rates is not addressed.¹⁸

Section 54-4a-6 provides objectives for the Division of Public Utilities in the performance of its activities "in the public interest." Among the objectives, the Division is to present "objective and comprehensive information, evidence and

¹⁷ In pertinent part, Section 54-3-1 provides:

All charges made . . . by any public utility . . . shall be just and reasonable. Every unjust or unreasonable charge made . . . is hereby prohibited and declared unlawful. . . . All rules and regulations made by a public utility affecting or pertaining to its charges or service to the public shall be just and reasonable. The scope of definition "just and reasonable" may include, **but shall not be limited to**, the cost of providing service to each category of customer, economic impact of charges on each category of customer, and on the well-being of the state of Utah; methods of reducing wide periodic variations in demand of such products, commodities or services, and means of encouraging conservation of resources and energy. [emphasis added]

¹⁸ In pertinent part, this statute provides:

Whenever the commission shall find after a hearing that the rates . . . charged or collected by any public utility for any service or product . . . are unjust, unreasonable, discriminatory or preferential, or in anywise in violation of any provisions of law, or that such rates . . . are insufficient, the commission shall determine the just, reasonable or sufficient rates . . . to be thereafter observed and in force, and shall fix the same by order as hereinafter provided.

recommendations” to the Commission to “provide for just, reasonable, and adequate rates.”¹⁹ The statute does not require that any particular methodology be utilized in achieving those objectives.

Many other sections of Title 54 refer to rates or to procedures involved in setting rates for utilities.²⁰ Many others do not mention rates, but establish

¹⁹ Subsection 4 enumerates several standards to guide the determination of what is “just, reasonable, and adequate:”

For purposes of guiding the activities of the Division of Public Utilities, the phrase “just, reasonable, and adequate” encompasses, but is not limited to the following criteria:

(a) maintain the financial integrity of public utilities by assuring a sufficient and fair rate of return;

(b) promote efficient management and operation of public utilities;

(c) protect the long-range interest of consumers in obtaining continued quality and adequate levels of service at the lowest cost consistent with the other provisions of Subsection (4).

(d) provide for fair apportionment of the total cost of service among customer categories and individual customers and prevent undue discrimination in rate relationships;

(e) promote stability in rate levels for customers and revenue requirements for utilities from year to year; and

(f) protect against wasteful use of public utility services.

²⁰ See Utah Code Ann. §§ 54-3-2 [requiring the filing and posting of rate schedules], 54-3-3 [providing for changes in rate schedules], 54-3-4 [providing for joint tariffs], 54-3-7 [requiring utilities to charge the rates contained in their filed schedules], 54-3-8 [forbidding preferences or unreasonable discrimination in rates charged various customers], 54-3-9 [allowing sliding scales in rates and

procedures that are applicable in setting rates.²¹ However, none describes, much

automatic adjustments in rates], 54-3-19 [restricting charges relative to the distance involved in the service], 54-4-2 [authorizing the Commission to conduct investigations and to hold hearings and enter orders based upon such investigations], 54-4-12 [allowing the Commission to set joint rates], 54-4-22 [indicating that rates may be based upon the value of properties or investments in the state and that no increase in rates may be found justified if the increase will result in earnings in an amount greater than a fair return on the value of properties], 54-7-9(3) [providing procedures that must be followed by customers in complaining about rates], 54-7-12 [providing detailed procedures that must be followed when any party seeks a rate increase or decrease], 54-7-20 [allowing reparations of rates charged under certain circumstances], 54-8b-3 and 54-8b-4 [authorizing the Commission to exempt certain utilities or services from rate regulation], 54-8b-6 [forbidding telecommunications corporations from subsidizing unregulated services through regulated services], 54-8b-10 [allowing the Commission to impose a surcharge on rates to assist in providing telecommunications devices to hearing and speech impaired persons], 54-8b-11 and 54-8b-12 [directing the Commission to make available high-quality, universal telecommunications services at just and reasonable rates for all classes of customers and allowing the Commission to establish a surcharge to assist in these objectives] and 54-10-4 [directing the Committee of Consumer Services to assess the impact of rate changes on residential and small commercial customers].

²¹ Utah Code Ann. §§ 54-3-3 [utilities cannot change their rates without filing new schedules with the Commission]; 54-3-7 [the utility charges filed with the Commission may not be deviated from, no refunds or rebates are to be made]; 54-3-8 [no preferences are to be given]; 54-4-1 [the Commission is granted power and jurisdiction to supervise and regulate the utility and to supervise all of its business and to do all things necessary to accomplish the matters set forth in the Public Utility Code]; 54-4-2 [the Commission has power to investigate compliance with its orders, to hold hearings with notice and to prepare findings and orders based thereon]; 54-4-4 [mandating the Commission to establish just and reasonable rates after hearing and by order]; 54-4-23 [the power to establish a system of accounts to be utilized by the utility and to review a utility's records]; 54-4a-1 [general oversight regulatory power of the Division of Public Utilities]; 54-7-9 [authorizing the Commission or consumers to file a complaint against the utility]; 54-7-12 [providing procedures to be followed any time rates are increased or decreased]; 54-7-13 [allowing the Commission to rescind or amend an order previously made after notice and an opportunity to be heard]; 54-7-15 [allowing any party to seek review or rehearing of a Commission order]; 54-7-17 [procedures to obtain a stay of a Commission order pending judicial review of the order]; 54-7-20 [giving customers a remedy to recover improper charges by utilities]; 54-7-21 to 25 [giving the Commission authority to enforce the Public Utility Code and its orders and to impose penalties upon and to enjoin a utility]; 54-10-1 *et seq.* [establishing

less mandates, the traditional cost of service ratemaking process that Appellants claim is the only permitted method of rate regulation.

B. There is no constitutional requirement that rates be set utilizing traditional cost of service ratemaking.

Although Appellants do not directly argue that traditional cost of service rate making is required under the state or federal constitutions, such an argument is a logical extension of their premise that traditional cost of service rate making is the only proper form of rate making for natural monopoly utilities, and is clearly relevant in considering whether Section 54-4-4.1 is constitutional.

The issue of the constitutionality of alternative types of regulation has arisen in several different contexts. It has been universally held that, so long as the end result of rate making is just and reasonable, no constitutional infirmity exists as a result of the rate making method employed. Furthermore, courts have held that rate moratoriums in which rates are held at fixed levels for varying periods of time are constitutional.

1. The end result and not the method of rate regulation determines whether rate making is constitutional.

From the outset of rate regulation, various interests have contended that certain methods or approaches to rate making were constitutionally required. For example, an argument similar to Appellants' was made by Utah Power & Light Company ("UP&L") in the 1940s. In Utah Power & Light Co. v. Public Serv. Comm'n, 107 Utah 155, 152 P.2d 542 (1944), UP&L argued that its rate base should

the Committee of Consumer Services and making it representative of residential consumers and small business in Commission proceedings].

be calculated on current fair value, rather than on original cost less depreciation, as a matter of both statutory and constitutional law. *Id.* at 545-46. This Court rejected that argument, at least in part on the basis of Federal Power Commission v. Hope Natural Gas Co., 320 U.S. 591 (1944):

The *Hope* case stands squarely for the doctrine that it is the final impact of the rate order which is controlling insofar as Federal constitutional limitations are concerned. So long as the rate set does not confiscate the property devoted to public service, the rate order will not be held to violate substantive constitutional principles. The legislature is free to determine its own economic policy in regard to the fixing of rates. Its power to set rates is, however, still circumscribed by two constitutional limitations: (1) substantive constitutional law requires that the rates finally set shall not be confiscatory; and (2) the requirements of procedural due process must still be followed.

UP&L, 152 P.2d at 553.

In UP&L, the Utah Supreme Court made it clear that there are only two constitutional limitations on the authority to regulate utility rates. The first—that the rates not be confiscatory—protects utilities from rates set so low that they do not provide a fair return on the capital invested in utility service. *Id.* at 568.²² The second—that procedural due process must be followed—protects all parties involved by ensuring that the Commission affords notice and an opportunity to be heard. Any method of regulation that complies with these two requirements is constitutionally valid. Significant by its absence was any mention of a constitutional right in ratepayers or the utility to have rates established in any particular manner. Thus, while the Constitution sets limits on how low rates may be set, it has not

²² See also, Bluefield Water Works & Improvement Co. v. Public Serv. Comm'n, 262 U.S. 679, 692 (1923); Missouri ex rel. Southwestern Bell Tel. Co. v. Public Serv. Comm'n, 262 U.S. 276 (1923).

mandated any upper limit on rates.²³

The holding of Hope, as approved by the Utah Supreme Court in UP&L, has been widely accepted and followed. It has been the basis for holding that various alternative methods of rate regulation are constitutional. For example, in In re Permian Basin Area Rate Cases, 390 U.S. 747, *reh. denied*, 392 U. S. 917 (1968), the United States Supreme Court held that the Constitution does not prevent the setting of maximum or price ceiling rates. In Wisconsin v. Federal Power Commission, 373 U.S. 294, 298-99 (1963), the Court upheld area rates based on reasonable financial requirements of the industry rather than on those of an individual company.

Recently, in Duquesne Light Co. v. Barasch, 488 U.S. 299 (1989), the United

²³ Although the Constitution has not set an upper limit on rates, this Court has provided the Commission guidelines on its duties to set just and reasonable rates. In Lewis v. Wycoff Co., 18 Utah 2d 255, 420 P.2d 264, 259 (Utah 1966), the Court stated that the Commission has the duty "of seeing that the public receives the most efficient and economical service possible." In Committee of Consumer Services v. Public Service Comm'n, 595 P.2d 871, 874 (Utah 1979) ["Wexpro I"], the Court stated that

it is the duty of a public utility corporation to operate in such a manner as to give to the consumers the most favorable rate reasonably possible. This duty stems from the fact the State has conferred on the utility of [sic] the exclusive right to sell and distribute gas. As a consequence, the utility bears a trust relationship to its customers and must conduct its operations on that basis and not as though it were engaged in a private enterprise with no restrictions as to its income.

These cases assist the Commission in entering a finding when it adopts a new form of regulation under Section 54-4-4.1 that the rates that result from the new form of regulation meet the "just and reasonable" test. Furthermore, the Utah Supreme Court has never expressly held that there is a **constitutional** ceiling on utility rates.

States Supreme Court held that the Constitution does not require the inclusion of investments in discontinued or abandoned generating facilities in rate base, even though the investments were prudent when made. The basis for the Court's holding was an act of the Pennsylvania Legislature prohibiting consideration of canceled plants. Holding that the statute did not violate the United States Constitution, the Court said:

It cannot seriously be contended that the Constitution prevents state legislatures from giving specific instructions to their utility commissions. We have never doubted that state legislatures are competent bodies to set utility rates. And the Pennsylvania PUC is essentially an administrative arm of the legislature. . . . We stated in *Permian Basin* 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." . . .

Similarly, an otherwise reasonable rate is not subject to constitutional attack by questioning the theoretical consistency of the method that produced it. "It is not theory, but the impact of the rate order which counts." [Citing *Hope*.] The economic judgments required in rate proceedings are often hopelessly complex and do not admit of a single correct result. The Constitution is not designed to arbitrate these economic niceties. . . . The Constitution protects the utility from the net effect of the rate order on its property. . . .

....

Hope clearly held that "the Commission was not bound to the use of any single formula or combination of formulae in determining rates." . . . In *Wisconsin v. FPC*, . . . the Court observed that:

"[T]o declare that a particular method of rate regulation is so sanctified as to make it highly unlikely that any other method could be sustained would be wholly out of keeping with this Court's consistent and clearly articulated approach to the question of the Commission's power to regulate rates. It has repeatedly been stated that no single method need be followed by the Commission in considering the justness and reasonableness of rates."

The adoption of a single theory of valuation as a constitutional requirement would be inconsistent with the view of the Constitution this Court has taken since *Hope Natural Gas, supra*, The designation of a single theory of rate making as a constitutional requirement would unnecessarily foreclose alternatives which could benefit both consumers and investors. The Constitution within broad limits leaves the States free to decide what rate-setting methodology best meets their needs in balancing the interests of the utility and the public.

Id. at 313-16.

Under Barasch, it is apparent that the traditional cost of service method is not the only constitutionally permitted method of rate making.

2. Plans which freeze rates for a reasonable period of time are not unconstitutional.

In Columbia Gas of West Virginia, Inc. v. Public Service Commission, 311 S.E.2d 137 (W.Va. 1983), the utility challenged the constitutionality of a statute allowing the commission to place a moratorium on rate increases for natural gas utilities for a period of one year. At the time the statute became effective, the utility was in the midst of a rate proceeding. The statute granted the commission discretion to suspend the proceeding during the period of the moratorium or to proceed with the case as if the statute had not been enacted. The commission proceeded with the case and found a rate increase justified, but then entered an order suspending the effectiveness of the increase during the moratorium. On appeal, the West Virginia Supreme Court upheld the constitutionality of the statute.

Similarly, rate freezes or moratoriums ranging up to three years in length have passed constitutional challenges. See, e.g., Permian Basin, 390 U.S. at 781 (two and one-half years); Trustees of Village of Saratoga Springs v. Saratoga Gas,

Electric Light and Power Co., 83 N.E. 693, 701 (1908) (three years).

The revenue sharing plan adopted by the Commission, if accepted by U S WEST, would not even have acted as a moratorium. U S WEST and other parties would have been free to request changes in rates during the period of the plan, which would have terminated the plan. Surely, if a complete moratorium passes constitutional muster, such a revenue sharing plan would also.

C. **Even without the statute, the Commission has broad authority in determining how to regulate rates.**

In UP&L, the Court considered UP&L's principal argument that, even if rate regulation based on original cost rate base was constitutionally permitted, it was contrary to the Public Utility Code. After reviewing several provisions of the Public Utility Code, the Court concluded:

These sections give the Commission general jurisdiction over utility rates. They empower the Commission to do all things necessary to supervise and regulate every utility in this state. They provide that rates are to be just and reasonable and direct the Commission to fix just and reasonable rates by order after hearing. These sections are broad and sweeping in scope. The limitations placed on the exercise of full legislative powers by said sections are: first, that the Commission proceed by notice and hearing; and second, that the rates established conform to the standard of "just and reasonable." These sections contain no mandate that rates be based on a fair value rate base.

UP&L, 152 P.2d at 555. Similarly, the Public Utility Code, as it exists currently, contains no mandate that traditional cost of service regulation is the only authorized method of setting rates.²⁴

²⁴ Appellants acknowledge that there is a wide range of different methods of rate regulation across a spectrum from cost of service rate making, to value of service ratemaking (used in transportation), least cost ratemaking, bidding, prospective rate setting on an average cost basis, affirmative price controls,

Since UP&L, the Court has reaffirmed on several occasions that the Commission's authority in setting rates is broad. See, e.g., Mountain States Tel. & Tel. Co. v. Public Serv. Comm'n, 754 P.2d 928, 931-32 (Utah 1988); Kearns-Tribune Corp. v. Public Serv. Comm'n, 682 P.2d 858, 859 (Utah 1984).

This Utah authority is supported by many cases from other jurisdictions. For example, in Montana-Dakota Utilities Co. v. Montana Department of Public Service Regulation, 752 P.2d 155, 157 (Mont. 1988), the court stated:

In determining what is just and reasonable, the PSC is not restricted to any single formula, if the method followed and the order entered 'when applied to the facts and viewed as a whole do not produce an unjust or arbitrary result.'

The PSC has the power to adopt any non-arbitrary method it chooses. In People's Organization for Washington Energy Resources v. Washington Utilities & Transportation Commission, 711 P.2d 319 (Wash. 1985), private and public consumer agencies challenged rate orders of the commission on the ground that it did not have authority to allow amortization by the utility of costs associated with a canceled nuclear generating facility in setting rates. On appeal, the court, noting the complexity of the issue presented, said:

Most states delegate their rate making power to regulatory agencies in very broad terms, basically just directing them to set those rates which the agencies determine to be just and reasonable. Washington is such a state. "[T]he statutory direction to the Commission in rate

"social contract ratemaking", banded ratemaking, "incentive" ratemaking, etc. App. Brief at 74. However, Appellants go on to assert, without citation of authority, that "[c]ost of service ratemaking is the universally developed system of ratemaking for natural monopoly utilities . . ." *Id.* Such a sweeping statement is plainly in error, as shown in UP&L, Hope, and Barasch. Even if it were true, it would not mean that the Constitution nor the Public Utility Code mandates cost of service ratemaking.

setting is broadly stated." The statutory mandate to the WUTC is to set fair, reasonable and sufficient rates.

People's Organization, 711 P.2d at 324-25. (Italics in original, citation omitted.)

In Maryland People's Counsel v. Heintz, 516 A.2d 599 (Md.App. 1986), *cert. denied*, 522 A.2d 393 (Md. 1987), the Maryland commission set rates for an intrastate, interLATA carrier within a range of reasonableness allowing the carrier flexibility in altering rates within the range. The court described the Commission's action as follows:

With respect to the establishment of these flexible rates, the Commission found that it was not wholly appropriate to rely exclusively on cost-of-service evidence and the "traditional" rate-making revenue requirement methodology

516 A.2d at 602. The order was challenged on the bases that the revenue requirement established by traditional cost of service analysis is the only amount that can be utilized in establishing a just and reasonable rate, and that the amount so established sets a maximum ceiling on just and reasonable rates.

In response to these contentions, the court said:

There is no requirement that there must be any given percentage of return on the fair value of property. Between the lowest return that is not unreasonable to the point of being confiscatory and the highest that is not inordinate, there is a rather wide zone in which a return may be reasonable under some circumstances and not under others. [Quoting with approval Baltimore Transit Co., 112 A.2d 687 (Md. 1955)] . . .

If the Commission is permitted leeway to determine the rate base and rate of return, but prohibited from exercising discretion in arriving at a just and reasonable rate based on those figures, this would exalt form over substance. . . .

Moreover, there is nothing in rate making which requires that

of return be a fixed percentage. All that is required is that the Commission determine a "reasonable return." [Citation omitted.]

516 A.2d at 606.

These cases illustrate that regulatory commissions are not bound to follow the traditional cost of service approach in setting rates. That is particularly the case where a legislature has specifically authorized the commission to consider and adopt alternative approaches, as it has done in Utah. If the Legislature had intended that the Commission could only establish "just and reasonable" rates by use of a cost-of-service approach, it could easily have so stated in the statute. That it has left the statutory standard in broad terms should be taken as an indication of its intent to grant the Commission discretion to determine rates through other methodologies. Section 54-4-4.1 simply clarifies that the Commission has such broad discretion, including the authority to adopt revenue sharing plans.

D. The Commission is required to set rates, not rate of return.

A basic flaw in Appellants' argument is the premise that the rate of return utilized in setting rates is a limit which is not guaranteed, but which cannot be exceeded. This premise is wrong.

There is nothing in the Public Utility Code that directs the Commission to set a rate of return that a utility may not exceed. To the contrary, Sections 54-4-4(1) and 54-4-7(12) specifically talk about the Commission setting **rates**, and Section 54-3-7 requires utilities to charge the **rates** set by the Commission.

If the Commission set a rate of return that could not be exceeded, then earnings in excess of that rate of return would be illegal and subject to refund, even though the utility was compelled by law to charge the rates that produced the

“excess” earnings. However, in Utah Dept. of Business Reg. v. Public Serv. Comm’n, 720 P.2d at 420-21 (Utah 1986), the Utah Supreme Court stated in reference to rate making that:

This process places both the utility and the consumers at risk that the rate-making procedures have not accurately predicted costs and revenues. If the utility underestimates its costs or overestimates revenues, the utility makes less money. By the same token, if a utility’s revenues exceed expectations or if costs are below predictions, **the utility keeps the excess.** (emphasis added)

Another case indirectly supports the proposition that rate of return may be a tool, but is not the end result, of rate making. In Utah Dept. of Business Reg. v. Public Serv. Comm’n, 614 P.2d 1242 (Utah 1980) [“Wage Case”], the Court considered whether the Commission could increase Mountain Fuel Supply Company’s (“MFS”) rates on the basis of two wage increases which occurred within several months after the conclusion of a general rate case. The order approving the increase found that the increase would not result in MFS earning in excess of a reasonable rate of return, but did not find the resulting rates just and reasonable. In reversing the order, the Court said:

One of the most significant deficiencies in the order was the omission of any finding the new rates were just and reasonable. Mountain Fuel urges such a finding is implicit within the finding concerning the reasonableness of the rate of return [I]t was impossible to determine whether the rates were just and reasonable without consideration of the other factors involved in making such a determination.

614 P.2d at 1246. Obviously, the Court did not regard rate of return as the *sine qua non* of rate making, as the Appellants do.

E. Rates that have been found just and reasonable do not become unjust or unreasonable just because they result in earnings in excess of or below the authorized rate of return.

Appellants' argument that rates set pursuant to a revenue sharing plan under Section 54-4-4.1 will be unjust and unreasonable is based on an assumption, made without citing any supporting authority, that if rates charged result in earnings in excess of the rate of return set by the Commission, they are unjust and unreasonable. In essence, they argue that earnings that exceed an authorized rate of return are ipso facto unjust and unreasonable, even when those earnings are the direct result of the rates set by a regulatory commission, which the public utility is required by law to charge. This argument not only ignores decisions of this Court, it ignores overwhelming authority from throughout the country that rates approved by a regulatory commission in a final order generally are presumed just and reasonable until found otherwise after hearing. Indeed, regardless of whether a utility is earning above or below its authorized rate of return, if it failed to charge the rates set by the Commission, it would be in violation of Section 54-3-7.

American Salt Co. v. W.S. Hatch Co., 748 P.2d 1060 (Utah 1987); Denver & Rio Grande R.R. v. Public Util. Comm'n, 73 Utah 139, 272 P. 939 (1928); and Utah-Idaho Cent. R.R. Co. v. Public Util. Comm'n, 64 Utah 54, 227 P. 1025 (1924), hold that rates set in final orders are just and reasonable and are not subject to reparations under Section 54-7-20.

It is universally accepted that public utilities are required to charge rates established by a commission in a general rate case and that such rates are

presumed just and reasonable until changed. For example, in Michigan Bell Tel. Co. v. Michigan Public Serv. Comm'n, 24 N.W.2d 200 (Mich. 1946), the Michigan Supreme Court held that

when a regulatory body has prescribed a rate to be charged for the future by a public utility and subsequently decides that such prescribed rate should be reduced, it cannot penalize the utility for collecting the rate during the period elapsing between the date of the order prescribing the rate and the date of the subsequent order reducing it.

Id. at 204.

In Arizona Grocery Co. v. Atchison, T. & S. F. Ry. Co., 284 U.S. 370 (1932), the Supreme Court of the United States held that, where the rate charged by a railway carrier was established by order of the Interstate Commerce Commission ("ICC"), the ICC could not thereafter subject the carrier to reparations by declaring that the rate it had previously fixed was in fact unreasonable.

In State ex rel. Boynton v. Public Serv. Comm'n, 11 P.2d 999 (Kan. 1932), the Kansas Supreme Court, interpreting the words "unjust and unreasonable" reached a similar holding. The court stated:

It seems clear that when a rate has been the subject of a deliberate inquiry in which the carriers, the shippers, and the commission's own experts have participated, as well as any and all other persons who cared to take a hand in it as the statute provides and permits, any rate so prescribed by the commission and put into effect by the carriers may be confidently collected and retained by them as their very own, without misgiving that at some future time a further hearing of the commission may be had and more evidence taken and a different conclusion reached and those rates condemned as unreasonable and reparation certificates allowed for the difference between the rates which the commission did authorize and the rates which it should have authorized. Such a method of regulating public utilities has none of the earmarks of due process of law nor of the simplest notions of justice. Nor would it be worth the while of any shipper to receive such a reparation certificate, for it would not serve

as a justiciable basis of recovery. That point, at least, was laid at rest by [Arizona Grocery].

Id. at 1006-07 (citations omitted).

The law in other jurisdictions comports with that in Utah and supports the sound rule that rates set by a commission in a general rate case are presumed "just and reasonable." They do not become ipso facto unjust and unreasonable simply because they result in earnings in excess of or below the rate of return used in setting them.

IV. THE LEGISLATURE MAY CONSTITUTIONALLY EMPOWER THE PUBLIC SERVICE COMMISSION TO ADOPT A REVENUE SHARING PLAN.

This section of the Brief will address Appellants' arguments dealing with the unconstitutional delegation of legislative powers to the Commission and to the Courts (App. Brief at 70-81). In addition, this section of Respondents' Brief will address the due process claims (*Id.* at 81) and antitrust policy constraints (*Id.* at 92) raised by Appellants.

Appellants state that "[t]hese issues arise in the event that the Court does strike down the exercise of the veto power granted the utility . . . and in the event the Court rejects Appellants' argument that the statute is not severable and must be stricken in its entirety." (*Id.* at 70). In those circumstances, Appellants argue that the Commission's decision to adopt a method of "incentive rate making" and the specific plan adopted would then be resurrected as the standing order of the Commission, and would therefore be ripe for review. (*Id.*) Appellants argue that the Court should therefore determine whether the incentive plan adopted by the Commission meets constitutional and statutory challenges.

Respondents disagree. If the Court strikes down Subsection 2 of Section 54-4-4.1, the Court need not determine any additional constitutional or statutory issues concerning Section 54-4-4.1 or the validity of the plan adopted by the Commission. As was stated in the section on mootness (Section I, *supra*), no plan is currently in effect in Utah as a result of U S WEST exercising its option under Subsection 2. Any decision to place an incentive plan in effect absent Subsection 2 should be left up to the Commission in a subsequent proceeding and not determined by the Court in this proceeding. The validity of any incentive plan, including its constitutionality, adequacy of findings of fact, and compliance with the Administrative Procedures Act, could be determined if and when the Commission determines to order a form of regulation different than is currently in effect today and someone appeals that decision to the Court. It appears to Respondents that if the Court determines that Subsection 2 is unconstitutional, it would be up to the Commission in a subsequent proceeding to determine if a change in current regulation is warranted. No incentive plan should be deemed in effect in the event Subsection 2 were declared unconstitutional.²⁵

A. The power to adopt a revenue sharing plan or any method of regulation consistent with Title 54 does not constitute an unconstitutional delegation of legislative power.

Appellants argue that the power to adopt any method of regulation consistent with "this title" in Section 54-4-4.1 means "that if the statute is upheld, the

²⁵ Although Respondents believe that no revenue sharing order would be in effect if subsection 2 is declared unconstitutional absent an additional order by the Commission, Respondents would have no objection to a remand to the Commission to determine if a change in current regulation should occur.

Commission can adopt any method of rate making it chooses and the limitation that the rates must be 'just and reasonable' ceases to have any independent meaning." (App. Brief at 70). Appellants also state that if a method of rate making expressly authorizes the collection of revenues in excess of those found to be "just and reasonable" by the Commission, the concept of justness and reasonableness will have lost all meaning as a guide in proceedings (*Id.* at 71).

As was stated previously, see § III(B), *supra*, the Constitution does not mandate or limit the Commission to the type of regulation defined by Appellants. No constitutional limitation is placed on permitting a method of rate regulation that would allow the utility to earn above the authorized rate of return found by the Commission in an earlier proceeding to be reasonable. The whole theory of "incentive" regulation is that the end result—the rates that will be charged customers during the revenue sharing plan period—would continue to be "just and reasonable." The economic principle that is espoused in a revenue sharing plan is that by allowing the utility to earn above its authorized rate of return, the utility would be induced to decrease costs compared to what would have happened under traditional regulation, so that the customer would be as well off or better off than under traditional regulation. As Appellants point out (App. Brief at 74), there is a wide range of different methods of rate regulation across a "spectrum" from cost of service rate making, to value of service rate making (used in transportation), least cost rate making, bidding, prospective rate setting on an average cost basis, affirmative price controls, "social contract rate making," banded rate

making, "incentive" rate making, etc.²⁶

When considering either a revenue sharing method of rate regulation, or any of the methods listed in Appellants' Brief, the Commission would continue to be required to find that the result of the method of rate regulation selected produces "just and reasonable" rates. The essential point is that the Constitution does not restrict the Commission to selecting only the method of rate regulation defined by Appellants, but frees the Commission to select a method of rate regulation which best suits the factual and economic conditions being presented to it.

1. The commission is entitled to engage in legislative functions so long as the functions are delegable functions.

Appellants argue that the delegation within Section 54-4-4.1 violates Article VI, Section 1, of the Utah Constitution, which provides:²⁷

The legislative powers of the state shall be vested:

1. In a Senate and House of Representatives which shall be designated the Legislature of the State of Utah.
2. In the people of the State of Utah, as hereinafter stated: . . .

²⁶ App. Brief at 74. It should be pointed out that the Commission is currently conducting two least cost planning proceedings. In the Matter of the Analysis of Least Cost Power Plan for Pacific Corp. Docket No. 90-2035-01, the Commission is investigating the role of least cost planning the electric utilities will use in Utah. In the Matter of the Analysis of an Integrated Resource Plan for Mountain Fuel Supply Company, Docket No. 91-057-09, the Commission is currently conducting an investigation into the use an integrated resource plan will have in establishing rates and terms and conditions of service in Utah. Further, the Commission in In the Matter of the Petition of The Mountain States Telephone and Telegraph Company for Exemption from Regulation of Various Central Office Based Services, Case No. 86-049-07, Report and Order (1-25-88) at 17-18, the Commission adopted banded rates for certain U S WEST services.

²⁷ App. Brief at 73.

Appellants cite several cases in which the Utah courts have declared laws unconstitutional because they delegated an essential legislative function such as defining a crime or imposition of a tax to an administrative agency. They cite no cases holding that **rate regulation** of a public utility cannot be delegated to an administrative agency such as the Public Service Commission.

2. The authority to set rates is a delegable legislative function.

Section 54-4-4.1 can only be an unconstitutional delegation of legislative authority if the power to regulate rates is a non-delegable function or if the legislature did not provide adequate standards or procedural safeguards to guide the Commission in regulating rates. It is undisputed and is universally accepted that legislatures may delegate their authority to regulate rates to administrative agencies.

In Peoples' Organization v. Washington Utility and Transportation Commission, 711 P.2d 319, 325 (Wash. 1985), the Washington Supreme Court observed:

The function of rate making is legislative in character and may be directly exercised by the Legislature itself or, as in the usual case, by administrative bodies endowed to that end

In this state, the Legislature has conferred the rate making power on the WUTC, subject of course, to appropriate judicial review.

No Utah case has been found with such an explicit statement of the principle that rate making is a delegable function. However, in Utah Dept. of Business Regulation v. Public Serv. Comm'n, 614 P.2d 1242 at 1250 (Utah 1980), this Court observed, in construing its powers to declare a rate order void and order a refund:

To undertake such a course would be tantamount to this Court

engaging in rate-making which is strictly a legislative power, for the P.S.C. in fixing and promulgating rates acts merely as an arm of the Legislature.²⁸

There can be no doubt that the Legislature may delegate to the Commission the authority to establish rates without violating Article VI, Section 1.

3. The cases cited by Appellants for an unconstitutional delegation of legislative powers are inapplicable.

Three of Appellants' cases, State v. Green, 793 P.2d 912 (Utah App. 1990), State v. Gallion, 572 P.2d 683 (Utah 1977) and State v. Goss, 11 P.2d 340 (Utah 1932) involved criminal prosecutions which were found unconstitutional because the laws or regulations under which the defendant was prosecuted involved the delegation to another entity of the essential legislative authority to determine what is a crime. The Supreme Court made it clear in these cases that delegation of authority to define a crime is different than many other types of delegations. In Gallion, 572 P.2d at 690, the Court stated:

There is a certain peril involved if administrative procedures can be applied to the criminal law . . . a determination of the elements of a crime and the appropriate punishment therefor are, under our Constitutional system, judgements, which must be made exclusively by the legislature.²⁹

Appellants also rely on Tite v. State Tax Commission, 57 P.2d 734 (Utah 1936) and Western Leather and Finding Co. v. State Tax Commission, 48 P.2d 526,

²⁸ See also Kearns Tribune Corp. v. Public Service Comm'n, 682 P.2d 858, 860 (Utah 1984); Utah Dept. of Admin. Serv. v. Public Service Comm'n, 658 P.2d 601, 621 (Utah 1983); Mountain States Telephone and Telegraph Co. v. Public Serv. Comm'n, 155 P.2d 184, 187-188, *reh. denied*, 158 P.2d 935 (Utah 1945); Utah Power and Light Co. v. Public Serv. Comm'n, 152 P.2d 542, 546-53 (Utah 1944); Mulcahy v. Public Serv. Comm'n, 117 P.2d 298, 302 (Utah 1941).

²⁹ See also State v. Green, *supra*, 793 P.2d at 916, n. 8.

528 (Utah 1935). Both cases involved imposition of taxes or penalties associated with taxes. In Tite, the Tax Commission was prohibited from determining the amount of penalty that should be assessed for non-compliance with a law requiring tax stamps to be affixed to cigarettes. The Court distinguished cases involving public utility commissions to whom authority had been granted "like the power to fix reasonable rates."

In Western Leather and Finding Co. v. State Tax Commission, 48 P.2d 526 (Utah 1935), the decision of the Tax Commission was overturned, not because it was an unconstitutional delegation of legislative authority, but because the Tax Commission had misinterpreted the statute. 48 P.2d 526 at 528.

In Rowell v. State Board of Agriculture, 99 P.2d 1 (Utah 1940), the Supreme Court struck down a statute that fixed the minimum market price for milk. The Court noted that the Legislature had not set forth any objectives, purposes, standards, measures or gauges to guide the Board in determining how the price of milk should be fixed. *Id.* at 3. The Public Utility Code is replete with objectives, purposes, and standards, the most notable being the "just and reasonable" standard applicable to rate making. This standard has been upheld as being adequate in Utah. The crucial difference between Rowell and the instant case is that the Public Utility Code provides an acceptable statutory standard that meets the requisite constitutional test.

Appellants also cite Athay v. State Dept. of Business Regulation, 626 P.2d 965 (Utah 1981). In Athay, an individual brought an action against the Department of Business Regulation for refusing to seat her at a state sanctioned psychol-

ogist examination. She was denied admission because the statute required her to have a course of studies in a doctoral program which was "primarily psychological." The Court determined that this standard was not sufficient. This decision cannot be used to stand for the proposition that "just and reasonable," "adequate," or other such standards included in the Public Utility Code are constitutionally insufficient. In fact, Utah courts have held just the opposite.

4. **The Utah Public Utility Code contains adequate standards and procedural safeguards to satisfy constitutional challenges.**

Appellants argue that Section 54-4-4.1 is an unconstitutional delegation because "it provides no legislatively defined standards by which the Commission shall make its choice and persons effected [sic] by the choice can judge or challenge the wisdom or merits of the choice made." (App. Brief at 75) This argument ignores the plain language of the Public Utility Code, which does set standards to guide the Commission's actions. It is also contrary to well reasoned authorities which hold that it is not necessary for the Legislature to provide standards as long as it provides safeguards against improper action by the Commission.

Section 54-4-4.1 provides that "[t]he commission may, by rule or order, adopt any method of rate regulation **consistent with this title**" [Emphasis added.] Title 54, the Public Utility Code, contains a myriad of standards with regard to rate regulation with which any method of regulation adopted by the Commission must comply. See Point III(A), *supra*.

Even if the phrase "consistent with this title" were absent from Section 54-4-4.1, it is unlikely that the statute would be found unconstitutional for lack of

adequate standards. Throughout their entire brief, Appellants look at Section 54-4-4.1 as an isolated statute. It is a well-accepted principle of law that statutes dealing with the same subject matter must be viewed as a whole. See Osuola v. Aetna Life & Casualty Co., 608 P.2d 242, 243 (Utah 1980); see also State ex rel. Cannon v. Leary, 646 P.2d 727 (Utah 1982); Cannon v. McDonald, 615 P.2d 1268 (Utah 1980).

Appellants cite White River Shale Oil v. Public Serv. Comm'n, 700 P.2d 1088 (Utah 1985) as the case that establishes the basic standards governing delegation of legislative power to the Commission.³⁰ We agree. White River clearly establishes that standards such as "just and reasonable," "adequate," or "public interest" are sufficient legislative standards to avoid a constitutional challenge for lack of adequate standards.

In White River, Utah Power and Light challenged the statute authorizing the Commission to issue cease and desist orders on the grounds that it was an unconstitutional delegation of judicial authority. This Court said:

As long as this delegation of authority is accompanied by adequate guiding standards and procedural safeguards to ensure that decision making by the Commission is not arbitrary and unreasoned, it is a constitutional delegation.

700 P.2d at 1091.

Section 54-7-4.5, the statute granting the Commission authority to issue cease and desist orders, has no standards for the Commission to apply in determining when it was appropriate to issue a cease and desist order. Nevertheless,

³⁰ See App. Brief at 72, n. 108

on the question of the adequacy of standards, this Court stated:

The provisions of the entire Public Utilities Act, U.C.A., 1953, § 54-1-1 to 11-10 (1974 and Supp. 1983) must be considered in determining whether there are sufficient guidelines established by the legislature. However, the primary sources of guidance are the declarations of legislative goals and policies which an agency is to apply when exercising its delegated powers.

These declarations need only be as specific as the circumstances warrant. The legislature need not lay down a detailed and specific set of guidelines which covers every conceivable problem that might arise in implementing the legislation. It is sufficient if there are general policies and standards articulated which provide direction to an administrative body possessing the expertise to adapt the legislative goals to varying circumstances.

It is undisputed that the PSC has been charged with the responsibility of regulating utilities in the public interest and that it has the necessary expertise to do so. Broad standards such as "reasonable", "unnecessary" and "public convenience and necessity" have been held to be sufficient as standards even though incapable of precise definition. "Public interest" certainly falls within this class of standards and, when read in light of the entire Public Utility Act, is not so broad as to result in an improper delegation of authority.

White River, 700 P.2d at 1091-92 (footnotes omitted).³¹

Standards of this type have universally been held to be sufficient to avoid constitutional delegation challenges. In Lloyd A. Fry Co. v. Utah Air Conservation Committee, 545 P.2d 495 (Utah 1975), the Court held that a statute which allowed the Utah Air Conservation Committee to "establish such emission requirements . . . as in its judgement may be necessary to prevent, abate or control air pollution" was a proper delegation of legislative power. Quoting from or citing

³¹ Other broad public utility standards have been upheld as adequate. See New York Central Securities Corp. v. United States, 287 U.S. 12, 25 (1932) ["public interest"]; National Broadcasting Co. v. United States, 319 U.S. 190, 225-226 (1943) ["public conveyance, interest or necessity"]; City Services Gas Co. v. State Corp. Comm'n., 416 P.2d 736 (Kan. 1966) ["in the interest of oil and gas conservation"].

other cases with approval, the Court said:

The provisions of the entire air conservation act must be considered in a determination of whether there are sufficient guidelines established.

“. . . Recognizing these facts the legislature acted to prohibit or control air contamination to the extent possible in the interest of health and the enjoyment of life or property. It is true that the standards set forth are broad, but they are nevertheless adequate.” [quoting Southern Illinois Asphalt v. Environmental Protection Agency, 303 N.E.2d 606, 611 (Ill. App. 1973)]

In *Lloyd A. Fry Roofing Company v. State Department of Health*, the court stated that in areas of legitimate legislative activity where precision was determined to be impossible, the courts have held such broad standards as "reasonable" and "necessary" sufficient as standards, although incapable of precise definition.

545 P.2d at 500 [citation and footnotes omitted].

The establishment of rates is the precise type of legitimate legislative activity where general standards such as "just and reasonable," "necessary," "adequate," and "public interest" are sufficient to withstand a constitutional challenge, although incapable of precise definition. Since there is no statutory or constitutionally required method of rate making and rate making is not susceptible to a scientific definition that is always appropriate, the Legislature delegated authority to the Commission to regulate rates, guiding them by general concepts which are contained in the Public Utility Act. Absent such flexibility, the very expertise that the Court recognizes in the Commission in applying these broad legislative goals would be lost. Appellants' argument is an attempt to limit the ability of the Commission to apply its expertise to differing economic circumstances that affect the public utilities in this state.

5. No Standards Are Required If A Delegation Is Accompanied With Adequate Procedural Safeguards.

The view that a legislature may constitutionally delegate authority to an administrative agency only if the delegation is accomplished by sufficient standards is becoming outdated and has been losing ground for some time. In Lloyd A. Fry Co., *supra*, this Court cited I Davis, *Administrative Law Treatise*, § 2.08 p. 113 for the proposition that:

[T]he law of delegation would be strengthened if the courts were to de-emphasize statutory standards and to emphasize the degree of procedural safeguards.

“ . . . Putting some words into a statute that a court can call a legislative standard is not a very good protection against arbitrariness. The protections that are effective are hearings with procedural safeguards, legislative supervision and judicial review. . . . ”

545 P.2d at 501 [footnotes omitted].

In Warren v. Marion County, 353 P.2d 257 (Ore. 1960), this view was expressed more strongly where the constitutionality of a county building code was challenged. The Oregon Supreme Court, also citing *Davis* and another administrative law treatise, said:

There is no constitutional requirement that all delegation of legislative power must be accompanied by a statement of standards circumscribing its exercise. It is true that a contrary view has frequently been expressed in adjudicative cases, particularly the earlier ones, but the position taken in such cases is not defensible. It is now apparent that the requirement of expressed standards has, in most instances, been little more than a judicial fetish for legislative language, the recitation of which provides no additional safeguards to persons affected by the exercise of the delegated authority. Thus, we have learned that it is of little or no significance in the administration of a delegated power that the statute which generated it stated the permissible limits of its exercise in terms of such abstractions as “public convenience, interest or necessity” or “unjust or unreasonable” or “for the public health, safety, and morals” and similar

phrases accepted as satisfying the standards requirement.

... [T]he important consideration is not whether the statute delegating the power expresses *standards*, but whether the procedure established for the exercise of the power furnishes adequate *safeguards* to those who are affected by the administrative action.

353 P.2d at 261 [citation omitted, italics in original].

There are adequate procedural safeguards in place to ensure that any method of regulation adopted by the Commission pursuant to Section 54-4-4.1 is subject to notice, hearing, and judicial review.³² Even if the Public Utility Code did not contain adequate procedural safeguards, the Commission's rules and the Administrative Procedures Act (Utah Code Ann. §§ 63-46b-1 *et seq.*) also apply to proceedings before the Commission and supply adequate procedural safeguards. In Earle M. Jorgensen Co. v. City of Seattle, 665 P.2d 1328 (Wash.), *cert. denied*, 464 U.S. 982 (1983), various industrial customers sought to set aside a rate order of the City of Seattle on various grounds including that the statute authorizing the city to set rates did not contain any procedural safeguards and was, therefore, unconstitutional. The Washington Supreme Court rejected this argument, stating:

Procedural safeguards need not inhere in the statute itself. If the statutory delegation provides inadequate guidelines, the procedural safeguards may be provided by the administrative body.

Id. at 1333 [citations omitted.]

In conclusion, in addition to adequate legislative standards such as "just

³² See in particular the discussion of procedural safeguards in Point III(A). Appellants clearly had ample opportunity to participate in the rate making process, and to challenge it judicially, as evidenced by this appeal.

and reasonable," adequate procedural safeguards exist within both the Public Utility Code and the Administrative Procedures Act to ensure that notice, hearing, and judicial review occur for any order issued by the Commission pursuant to Section 54-4-4.1.

B. The power to adopt a revenue sharing plan does not constitute an unconstitutional delegation of judicial power.

Appellants argue that

[t]o the extent that Utah Code Ann. § 54-4-4.1 and the statutes delegating power to the courts to review Commission decisions delegates power to a reviewing court to modify or select a different method of rate regulation than that chosen by the Commission, it would constitute a violation of the separation of powers provision of the Utah Constitution, Article V, Section 1 . . .

(App. Brief at 81). It is inconceivable that this Court would ever attempt to establish rates, let alone a method of rate regulation under the statute. Appellants' argument is a complete misreading of the type of authority the Court has exercised over Commission decisions.

The review by the Supreme Court of Commission decisions is consistent with Article V, Section 1 of the Utah Constitution. Since Marbury v. Madison, 5 U.S. (1 Cranch) 137 (1803), it has been accepted constitutional law that the judiciary may review the acts of the legislature. This review also extends to administrative bodies that have had legislative duties properly delegated to them. Justice Marshall stated:

It is emphatically the province and duty of the judicial department to say what the law is. Those who apply the rule to particular cases, must of necessity expound and interpret that rule. If two laws conflict with each other, the courts must decide on the operation of each. . . .

The Utah Supreme Court has approved the concept of judicial review described in Marbury in Jenkins v. Swan, 675 P.2d 1145, 1149 (Utah 1983). The Utah Supreme Court acts within constitutional bounds when it reviews orders of the Commission to see if they comport with the constitutions of the state and the United States, if they violate any laws established by the Legislature, or if they are arbitrary or capricious.

The suggestion that the statute delegates power to the reviewing Court to modify or select a different method of rate regulation than that chosen by the Commission is based on a misunderstanding of the Court's role in the rate making process. In Telecommunications Resellers v. Public Serv. Comm'n, 747 P.2d 1029, 1031 (Utah 1987), the Court set forth the extent of its review of rate orders:

Nor does this Court have authority to modify or partially set aside a PSC order. . . . We have occasionally remanded matters to the PSC with guidelines, . . . or with suggestions as to possible future dispositions. . . . Nonetheless, upon hearing a petition, this Court is only empowered to affirm or set aside a PSC order.³³ [citations omitted]

In Utah Dept. of Business Regulation v. Public Serv. Comm'n, 614 P.2d 1242, 1250 (Utah 1980), the Court stated:

The Division further urges this Court to declare the order of the P.S.C. invalid and void from its inception, and to order the amounts collected thereunder to be refunded. To undertake such a course would be tantamount to this Court engaging in rate-making, which is strictly a legislative power, for the P.S.C. in fixing and promulgating rates acts merely as an arm of the Legislature. The review by this Court of the orders of the P.S.C. is confined to the legal issues of

³³ See also Mountain States Telephone and Telegraph Co. v. Public Serv. Comm'n, 155 P.2d 184, 188 *reh. denied*, 158 P.2d 935 (1945); Salt Lake Transfer Co. v. Public Serv. Comm'n, 355 P.2d 706, 711 (Utah 1960).

whether there is substantial evidence to sustain the findings of the P.S.C.; whether the P.S.C. has exercised its authority according to law; and whether any constitutional rights of a complaining party have been invaded or disregarded. Any interference by this Court beyond the aforementioned limits would constitute an interference with the law making power of this state.

It is apparent that the Court does not have and has never asserted the authority to select a different method of rate regulation than that utilized by the Commission or to modify the Commission's method. If the Court determined that there is a defect in an order of the Commission, the Court can reverse the order and remand it to the Commission for further proceedings. Thus, Appellants' argument has no merit.

C. Section 54-4-4.1 does not violate Article I, Section 7 of the Utah Constitution relating to due process of law.

Appellants claim that the enactment and subsequent application of Section 54-4-4.1 violates their due process rights under Article I, Section 7 of the Utah Constitution, and that application of the statute may constitute a confiscation of their property.³⁴ This argument fails when viewed in light of state and federal constitutional law.³⁵

³⁴ Appellants cite several cases for this proposition, but none is directly on point. Appellants rely principally on Meyers v. Blair Tel. Co., 230 N.W.2d 190 (Neb. 1975), and its progeny, which state that consumers are entitled to the same protection against confiscation of property as utilities. This case was decided in the context of a utility that was providing woefully inadequate service. The Nebraska commission ultimately reduced rates because of the service problems. These cases are in no way analogous to the instant case. Utah Copper Co. v. Public Util. Comm'n, 59 Utah 191, 203 P. 627 (1921), does not apply due process principles to ratepayers.

³⁵ The Utah Supreme Court has stated that decisions by the United States Supreme Court interpreting the Fifth and Fourteenth Amendments to the United States Constitution are highly persuasive to the application of the due process

1. Appellants have not identified a due process property interest in utility rates or ratemaking methodology.

The requirements to establish a constitutionally protected property interest under the due process clause are set forth in Board of Regents v. Roth, 408 U.S. 564 (1972):

The Fourteenth Amendment's procedural protection of property is a safeguard of the security of interests that a person has already acquired in specific benefits. . . .

. . . To have a property interest in a benefit, a person clearly must have more than an abstract need or desire for it. He must have more than a unilateral expectation of it. He must, instead, have a legitimate claim of entitlement to it. It is a purpose of the ancient institution of property to protect those claims upon which people rely in their daily lives, reliance that must not be arbitrarily undermined. It is a purpose of the constitutional right to a hearing to provide an opportunity for a person to vindicate those claims.

Property interests, of course, are not created by the Constitution. Rather, they are created and their dimensions are defined by existing rules or understandings that stem from an independent source such as state law rules or understandings that secure certain benefits and that support claims of entitlement to those benefits.

Id. at 576-77.

Appellants have not identified the specific property interest they claim they are being deprived of without due process of law. The gist of their argument is that they were not be able to participate meaningfully in a proceeding under the Statute without additional standards.

It has been a recognized principle of constitutional and public utility law that utility customers do not have a protected property interest in their utility rates

clause in the Utah Constitution. See Untermeyer v. State Tax Comm'n, 102 Utah 214, 129 P.2d 881, 885-86, *rev'd on other grounds*, 316 U.S. 645 (1942).

under the due process clause. See, e.g., Miles v. Idaho Power Co., 778 P.2d 757, 766-67 (Idaho 1989); In Re Implementation Of Utility Energy Conservation Improvement Programs, 368 N.W.2d 308, 313 (Minn. App. 1985). Utah law has not entitled Appellants to rely on the due process clause of the state constitution to attack ratemaking methodologies that displease them.³⁶

The Legislature has established other avenues by which Appellants can complain about rate increases, rate decreases or rate-making methodologies. These avenues are found in the Public Utility Code.

2. Even if Appellants have a "property interest" in their utility rates, the requirements of due process have been addressed under the Public Utility Code.

In many respects, the arguments presented by Appellants relating to Article 1, Section 7 of the Utah Constitution (App. Brief at 81-92) are the same or similar arguments made by Appellants relating to the delegation of legislative powers to an administrative agency. Appellants argue that they are deprived of due process because Section 54-4-4.1 contains no standards to govern rate making. As has been previously established, the Public Utility Code as a whole provides sufficient standards to guide the Commission.

The United States Supreme Court has set forth the requirements for due process in Cleveland Bd. of Education v. Loudermill, 470 U.S. 532, 546 (1985) where

³⁶ It has been held that a utility has no due process property interest in a particular ratemaking methodology. See Southwestern Bell Tel. Co. v. Arkansas Public Serv. Comm'n, 593 S.W. 2d 434 (Ark. 1980); Southwestern Bell Tel. Co. v. Arkansas Public Serv. Comm'n, 720 S.W.2d 924 (Ark.Ct.App. 1986). Surely individual consumers, who have less to lose, cannot be said to have due process rights in any ratemaking methodology.

it stated:

The essential requirements of due process . . . are notice and an opportunity to respond. The opportunity to present reasons, either in person or in writing, why proposed action should not be taken is a fundamental due process requirement.

The principles of due process have been discussed by the Utah Supreme Court in two public utility cases. In Fuller-Toponce Truck Co. v. Public Serv. Comm'n, 96 P.2d 722, 725 (Utah 1939), the Court stated:

The . . . question [of due process] is self-answered because we have held that in this case there was due process of law. The Commission conformed to every step laid down by the statute with the exception of the 20 day period heretofore discussed and found to be directory only. . . . "The essential elements of due process of law are *notice*, an *opportunity to be heard* and to *defend* in an orderly proceeding adapted to the nature of the case before a tribunal having jurisdiction of the case." [quoting 12 Am. Jur. Constitutional Law § 573]

In Salt Lake County v. Public Serv. Comm'n, 510 P.2d 923 (Utah 1973), the Court reaffirmed these principles. In Salt Lake County, the Salt Lake County attorney did not attend all of the Commission hearings in a rate proceeding. The Court determined that the County had not been deprived of due process of law, stating as follows:

We think the plaintiff hardly can complain of surprise or lack of notice. The record abounds with facts reflecting that it knew what was astring, and when, where, and why it was. Opportunity to examine everything, cross examine anyone and otherwise to become autoptic in this case, after its intervention was granted. It absented itself from some of the hearings, and later, with permission, walked out of the last it attended, with the urgency of the Commission that counsel's body might repose in absentia, but with the county's body politic still occupied a ringside seat in this encounter. Since plaintiff intervened it was particeps at all times, and actually, before its counsel's departure it joined in a pleading asking for the very re-allocation which it now negates.

Id. at 924.

Hardly can Appellants claim that it has not had an opportunity to fully participate in the proceedings before the Public Service Commission. Counsel for Appellants participated in the proceedings and cross examined witnesses. (*E.g.* R. 1331-52, 1577-1604, 1622-42, 1795 -1806, 1950-58, 1997-2000, 2024-34, 2076-85, 2726-49). Appellants chose to present no evidence to the Commission. The level of their participation cannot be used as a denial of their due process.

Appellants cloak their due process argument into what they claim is the lack of notice within Section 54-4-4.1 itself of standards the Commission will use in adopting a rate regulation methodology. This argument is in part a duplication and in part a variation on the argument that the statute is an unconstitutional delegation because it does not contain sufficient standards (see Point IV(A)(3), *supra*).

The Public Utility Code is comprised of a series of standards, not just to provide a mechanism by which the Commission may establish rates, but also to afford parties due process rights of notice and hearing in rate making proceedings. There are many sections of the Public Utility Code that provide procedural standards for purposes of rate setting which applied to the adoption of a method of rate regulation under Section 54-4-4.1. Any method of rate regulation adopted pursuant to Section 54-4-4.1 would have to comply with all of these restrictions.

Appellants cite Rowell v. State Board of Agriculture, 99 P.2d 1 (Utah 1940) to support their due process argument. In that case, the Utah Supreme Court struck down a statute which fixed the minimum market price for milk. The Court noted that the Legislature had not set forth any objectives, purposes,

standards, measures or gauges to guide the Board in determining how the price of milk should be fixed. *Id.* at 3. As was stated, *supra* Section IV, the Court has upheld the standards adopted by the legislature to guide the Commission as being adequate.

Appellants also cite at Athay v. State Dept. of Business Regulation, 626 P.2d 965 (Utah 1981) to support both their due process argument and their delegation of legislative powers argument. As was stated previously, the courts have held that the "just and reasonable" standard is a sufficient guideline for the Commission unlike the standard discussed in Athay.

Appellants also argue that the statute violates the due process clause because of vagueness (App. Brief at 89). The United States Supreme Court has outlined the standards that are applicable to statutes to determine if they are impermissibly vague. In Connolly v. General Const. Co., 269 U.S. 385, 391 (1926) the Court stated:

[A] statute which either forbids or requires the doing of an act in terms so vague that men of common intelligence must necessarily guess at its meaning and differ as to its application violates the first essential of due process of law.

In more recent times, the United States Supreme Court has held that differing standards of vagueness apply to criminal and civil statutes. In Village of Hoffman Estates v. Flipside, Hoffman Estates, Inc., 455 U.S. 489, 498-99 (1982), the Court said:

The degree of vagueness that the constitution tolerates – as well as the relative importance of fair notice and fair enforcement – depends in part on the nature of the enactment. Thus, economic regulation is subject to a less strict vagueness test because its subject matter is often more narrow, and because businesses, which face economic

demands to plan behavior carefully, can be expected to consult relevant legislation in advance of action. Indeed, the regulated enterprise may have the ability to clarify the meaning of the regulation by its own inquiry, or by resort to an administrative process.

A Michigan Appellate Court set out specific standards which can be utilized in reviewing public utility statutes to determine if they are vague. In Attorney General v. Public Serv. Comm'n, 411 N.W.2d 469, 471 (Mich. App. 1987), the Court stated:

First, the act in question must be read as a whole; the provision in question must be construed with reference to the entire act. Next, the standard should be as reasonably precise as the subject matter requires or permits. Third, if possible, the statute must be construed as being valid, that is, it must be construed as confirming administrative, not legislative, power and as giving discretionary, not arbitrary, authority. Last, the statute must satisfy due process requirements.

Section 54-4-4.1 meets all of these criteria. It states that the Commission has authority to adopt any method of rate regulation that is consistent with the Public Utility Code, including a method under which an equitable sharing of earnings above some level occurs. When the statute is read with the entire Public Utility Code in mind it is apparent that its purpose is to clarify that the Commission is not limited to only one method of rate regulation. All of the same standards, rules and regulations, safeguards of the Public Utility Code and the Administrative Procedures Act apply to any method of rate regulation adopted by the Commission pursuant to this statute. The statute is reasonably precise given the subject matter. Rate making is a complex matter which does not lend itself to specific rigid formulas. Section 54-4-4.1 does not grant the Commission unbridled authority. It restricts the Commission to adopting methods of rate regulation

consistent with Title 54. This type of discretion has been found to be sufficient to guide the Commission.

Appellants also argue that adopting an order under Section 54-4-4.1 would violate the Utah Administrative Rules Act (UARA). The UARA clearly distinguishes between rules and orders, and establishes that rule making is not applicable where an agency proceeds by order, rather than by rule. Utah Code Ann. § 63-46a-2(14)(a) defines a “rule” as:

An agency's written statement that:

- i. is explicitly or implicitly required by state or federal statute or other applicable law;
- ii. has the effect of law;
- iii. implements or interprets a state or federal mandate;
- iv. applies to a class of persons or another agency.

Section 63-46a-2(9) defines a “order” as “an agency action that determines the legal rights, duties, privileges, immunities, or other interests of one or more specific persons but not a class of persons.” Section 63-46a-2(14)(c)(i) specifically provides that “rule” does not mean “order” and Section 63-46a-2(14)(c)(vii) specifically provides that “rule” does not mean “rulings by an agency in adjudicative proceedings.” In the present case the Commission chose to proceed under Section 54-4-4.1 by means of an order without following the procedural requirements of the UARA. Such an order does not fall within the definition of a “rule” because it is not a written statement that is required by statute or other applicable law, does not implement or interpret a legal mandate, and does not apply to a class of persons or another agency. Instead, the Commission's order issued in this proceeding, if accepted by U S WEST, would have determined the legal rights and duties of U S

WEST but not of other telephone corporations or other public utilities in the State of Utah. The Commission's order in this case constitutes a ruling in an adjudicative proceeding which is outside the meaning of a "rule."

Appellants' reliance on Williams v. Public Serv. Comm'n, 720 P.2d 773 (Utah 1986) is misplaced. First, the operative section of UARA have been amended since Williams was decided.³⁷ Second, Williams simply held that the Commission could not reverse a long standing policy of asserting jurisdiction over one-way paging services by means of a letter to one party, but rather had to engage in rule making in order to make such a change. In the present case, the Commission's adoption of an incentive rate plan for U S WEST did not change policy regarding any other public utility.

Even if the Court determined that rule making is an appropriate procedure for the Commission to follow, no incentive plan is currently in effect to cause any harm to Appellants. Respondents have indicated that if the "veto" provision is found unconstitutional, the incentive plan ordered by the Commission in this case should not go into effect absent further proceedings by the Commission. Finally, the purpose of UARA is to provide an opportunity for public comment prior to any agency action. Appellants can hardly claim that they have not been given an opportunity to present their views on incentive regulations at the hearings that

³⁷ Prior to 1988, UARA defined "rule" as a "statement of general applicability . . . that implements or interprets the law or prescribes the policy of the agency in the administration of its functions" The current version of UARA defines "rule" as quoted above.

occurred before the Public Service Commission.³⁸

D. State antitrust policy does not prohibit adoption of any method of rate regulation consistent with the Public Utility Code including a method of revenue sharing.

The arguments presented by Appellants (App. Brief at 92-96) relating to Utah antitrust statutes and Article XII, Section 20 of the Utah Constitution are completely misplaced in a proceeding attempting to declare unconstitutional a provision of the Public Utility Code. Appellants themselves acknowledge that Utah's constitutional provision and statutes regarding antitrust do not prohibit adoption of a revenue sharing plan. (App. Brief at 93). Rather, Appellants argue that "the basic policy of protecting the public interest by ensuring that private economic power shall be subject to a competitive process or effectively regulated" requires rejection of a revenue sharing rate regulation plan because U S WEST would be able to earn "monopolistic profits" under such a plan. *Id.*

In essence, Appellants are presenting an economic/regulatory policy statement that is not mandated by any law. In fact, the Utah Legislature has explicitly recognized revenue sharing plans as being valid methods of regulation. Utah law does not define nor prohibit "monopoly profits," it has never required that the Commission establish a single point rate of return, nor has it ever held that earnings above an authorized rate of return are unlawful. The Public Utility Code requires that rates be "just and reasonable" without specifying limits as to

³⁸ All parties were given an opportunity to present briefs on the issue of incentive regulation. U S WEST (R. 5156-90), the Division (R. 5201-22), the Committee (R. 5136-55), MCI (R. 5191-5200) and Contel (R. 5126-35) filed briefs. Appellants chose not to file a brief.

what the Commission may deem to be a "just and reasonable" rate.

The legislature establishes both the state's antitrust policy and the state's utility regulation policy. Since the legislature has specifically authorized revenue sharing plans, it must be presumed that it did so with the state's antitrust policy in mind. Appellants' antitrust argument has no merit, and should be rejected by the Court.

V. THE LEGISLATURE MAY CONSTITUTIONALLY EMPOWER A PUBLIC UTILITY TO REJECT A REVENUE SHARING PLAN.

Appellants did not first address the constitutionality of the substance of Section 54-4-4.1, which empowers the Commission to adopt alternative forms of regulation consistent with Title 54, including revenue sharing plans. Rather, they argue in Point I of their Brief that Subsection 2 is unconstitutional because it allows a public utility to "elect not to proceed" with a revenue sharing plan adopted by the Commission. This section of Respondents' Brief will demonstrate that the statutory recognition of such a right in utilities suffers from no constitutional infirmity.

A. The power to reject a revenue sharing plan does not constitute an unconstitutional delegation of legislative power.³⁹

In a strained extension of their unconstitutional delegation argument,

³⁹ Although Appellants assert in the heading to Point I of their brief that Utah Code Ann. § 54-4-4.1(2) is an unconstitutional delegation of **judicial** power to a private party, they do not cite any legal authority dealing with delegation of judicial power, nor do they otherwise make a discernibly separate argument on delegation of judicial power. Accordingly, this section will be confined to the question of delegation of legislative power.

Appellants contend that, because utilities have the right to opt out of any revenue sharing plan adopted by the Commission, Section 54-4-4.1(2) unconstitutionally delegates legislative and judicial power to private persons.⁴⁰ Appellants fail to recognize that Section 54-4-4.1(2) is in essence a codification of the firmly established rule against retroactive rate-making, under which it is generally unlawful to require a customer to make up lost profits for a utility or to require a utility to return earnings above its authorized rate of return to ratepayers. *See, e.g.* Section 54-4-4(1) (empowering the Commission to determine just and reasonable rates "to be **thereafter** observed and in force"); Arizona Grocery Co. v. Atchison, T. & S.F. Ry. Co., 284 U.S. 370, 389 (1932); Utah Dep't of Business Regulation v. Public

⁴⁰ App. Brief at 59-65. Note that the veto power exists only with respect to revenue sharing plans, not with respect to other forms of regulation that the Commission may adopt, such as traditional, cost-of-service regulation. Utah Code Ann. § 54-4-4.1(2).

The two federal cases cited by Appellants have nothing to do with delegation of legislative power to private persons, and are easily distinguishable from the present case. In Immigration and Naturalization Service v. Chadha, 462 U.S. 919 (1983), the court struck down a statute that permitted one branch of Congress to invalidate, by resolution, a decision of the Executive Branch to allow a particular deportable alien to remain in the United States, holding it to be a violation of separation of powers in that the Congress was permitted to overrule the exercise of executive authority without pursuing the constitutionally mandated legislative process. In Consumer's Union of U. S., Inc. v. Federal Trade Comm'n, 691 F.2d 575 (D.C. Cir. 1982), *aff'd sub nom.*, Process Gas Consumers Group v. Consumer Energy Council of America, 463 U.S. 1216 (1983), the court invalidated a statute that permitted Congress to veto any rule promulgated by the FTC. As in Chadha, it was held to be a violation of the separation of powers provisions of the Constitution. The court expressly declined to decide whether there was an improper delegation of administrative power to Congress without any standards for the exercise of that power.

In the present case, the statute does not purport to grant powers of one branch of government to another, nor to give one branch of government veto power over the acts of another branch. Utility rate making is a strictly legislative function, which may be delegated to an administrative agency. *See* discussion, Point IV(A), *supra*. Thus there is no issue of separation of powers in this case.

Service Comm'n, 720 P.2d 420-21, 423 (Utah 1986) ("[I]f a utility's revenues exceed expectations or if costs are below predictions, the utility keeps the excess. . . . [A]ll rate making must be prospective in effect. . . ."); see also Public Utilities Comm'n v. United Fuel Gas Co., 317 U.S. 456, 464, *reh. denied*, 318 U.S. 798 (1943). The only difference is that under the statute, the utility is permitted to exercise its right to challenge retroactive rates by notice to the Commission, rather than through judicial proceedings. Thus even without the statutory veto power over revenue sharing plans, a utility would still have a de facto veto power. See, People v. Waisvisz, 221 Ill. App. 3rd 667, 582 N.E. 2d 1383, 1386 (1991) ("[A] mere grant of authority by the legislature to a private entity to exercise, with the full backing of the law, a right possessed by the entity at common law is not an impermissible grant of legislative power.")

The rule against retroactive rate making is not simply a common law prohibition, but has been held to be based on state and federal constitutions. In Straube v. Bowling Green Gas Co., 227 S.W.2d 666, 671 (Mo. 1950), the Missouri Supreme Court, citing Arizona Grocery, stated as follows:

When the established rate of a utility has been followed, the amount so collected becomes the property of the utility, of which it cannot be deprived by either legislative or judicial action without violating the due process provisions of the state and federal constitutions.⁴¹

⁴¹ Accord, South Central Bell Telephone Co. v. Louisiana Public Service Comm'n, 594 So.2d 357 (La. 1992); City of El Paso v. Public Utility Comm'n, 1991 WL 155113 (Tex. App. 1991); Kansas Gas & Elec. Co. v. State Corp. Comm'n, 794 P.2d 1165, 1170 (Kan. App. 1990); In re Central Vermont Public Service Corp., 473 A.2d 1155, 1158 (Vt. 1984); State ex rel. Barvick v. Public Service Comm'n, 606 S.W.2d 474, 476 (Mo. Ct. App. 1980); General Telephone Co. v. Michigan Public Service Comm'n, 78 Mich. App. 528, 260 N.W.2d 874, 21 P.U.R. 4th 569 (Mich App. 1977); Mountain States Tel. & Tel. Co. v. New Mexico State Corp. Comm'n, 90

Thus, whether or not the veto power is stated explicitly in the statute, if the Commission were to adopt a revenue sharing plan against the will of a utility, it could result in a deprivation of the due process rights of the utility and would result in a violation of the statutory requirement that rates be set prospectively only.⁴² Thus, contrary to Appellants' argument, Section 54-4-4.1 would probably be declared unconstitutional, as applied to a revenue sharing plan, if the utility's right to reject such a plan were **not** incorporated into the statute, either expressly or impliedly.

Appellants assert that the "principles prohibiting [delegation of legislative power to a private party] are so self-evident, that such a naked delegation of power to a private party is seldom tried by a state legislature." (App. Brief at 61) However, they fail to note that vesting certain types of consent power in private parties has withstood constitutional challenge. For example, in State Theatre Co. v. Smith, 276 N.W.2d 259 (S.D. 1979), the court rejected an argument that a statute permitting affected neighbors to "veto" the amendment of a zoning ordinance was an

N.M. 325, 563 P.2d 588, 19 P.U.R. 4th 318 (N.M. 1977).

⁴² The foregoing discussion is sufficient response to Appellants' argument that it is unconstitutionally unfair (i.e. a deprivation of due process) for a veto power to rest in the public utility, but not in others, such as themselves. The veto power could only affect a plan in which a utility was being asked to relinquish its existing right to retain earned revenues. That right belongs solely to the utility. Other parties do not have the right to require a utility to make refunds of earned revenues. In fact, it has been held that utility ratepayers do not have a vested due process right in utility rates. If the PSC adopted a revenue sharing plan that required customers to make up lost profits, such a plan would violate the rule against retroactive rate making and therefore would not be consistent with Title 54. See *infra*, Section IV(C)(1).

unconstitutional delegation of power. The court explained:

The validity of consents has long been debated; the absence of standards relating to the giving of consents has been a major ground for the invalidity of consent statutes. There appear to be two categories of consent statutes: those requiring consent to establish a restriction and those requiring consent to waive a restriction. The former are invalid and the latter valid.

276 N.W.2d at 263. Similarly, in Brock v. Superior Court, 9 Cal. 2d 291, 71 P.2d 209, 213 (1937) (dealing with a statute regulating the marketing of citrus, which required the approval of private parties before the director of agriculture could enter into a marketing agreement), the court stated that "a statute is not invalid merely because it provides for consent of interested persons to the contemplated regulation." Thus Appellants' over broad statement that all delegations of consent power to private persons are unconstitutional is in error.⁴³ In the present case, where the power to veto a revenue sharing plan is in effect a power to consent to a waiver of the rule against retroactive ratemaking, there is no constitutional infirmity.

Appellants cite Revne v. Trade Comm'n, 113 Utah 155, 192 P.2d 563, 3 A.L.R.2d 169 (1948) and Union Trust Co. v. Simmons, 116 Utah 422, 211 P.2d 190 (1949), in support of the proposition that it is unconstitutional for the Legislature to

⁴³ See generally, Annot., Delegation of legislative power to nongovernmental agencies as regards prices, wages, and hours, 3 A.L.R.2d 188 §§ 5-7 & fn. 3 (1949) (citing legal journal articles). The annotation also notes: "As regards delegation of the rate-making power to private corporations, it should be remembered that in the past public utilities frequently received by franchise the power to fix rates." *Id.* at 192. See also, Jaffe, "Law making by private groups," 51 Harv. L. Rev. 201, 218, (1937).

delegate legislative authority to a private entity.⁴⁴ In Revne, the statute under

⁴⁴ The other cases cited by Appellants in support of the proposition that no legislative power may be delegated to private parties are distinguishable. Appellants' Brief at 61-62, n. 95. In none of the cited cases did a private party have an already existing constitutional right, which was statutorily recognized by the legislature, as in this case.

In Rowell v. State Board of Agriculture, 98 Utah 353, 99 P.2d 1 (1940), the court did not even address delegation of power to a private party.

In Southern Pacific Trans. Co. v. Public Util. Comm'n, 556 P.2d 289 (Cal 1976), the court found there was no unconstitutional delegation to a private party, because there were implicit safeguards to guide an administrator's actions in ordering a highway crossing abolished. In fact, the court stated: "**Acts of private parties prerequisite to operation of a statute containing valid standards for action do not constitute unlawful delegation.**" 556 P.2d at 293 (emphasis added).

In Colorado Energy Advocacy Office v. Public Serv. Comm'n, 704 P.2d 298 (Colo. 1985), the court refused to find an unconstitutional delegation of power to a utility, where the public utilities commission approved a tariff that allowed the utility to make adjustments of its purchased gas cost estimates without prior approval of the commission.

In Corvallis Lodge No. 1411 v. Oregon Liquor Control Comm'n, 677 P.2d 76 (Or. App. 1984), the court invalidated a statute that delegated certain power to commercial liquor vendors, not because the power was delegated, but because there were not sufficient procedural safeguards against the arbitrary exercise of that power.

In Industrial Comm'n v. C&D Pipeline, Inc., 607 P.2d 383 (Ariz App. 1979), the court found an unconstitutional delegation of power because it allowed labor unions to set wages which the commission was bound to accept. In the present case, in contrast, any revenue sharing plan must receive Commission approval. Cf. Arizona Downs v. Arizona Horsemen's Foundation, 130 Ariz. 550, 637 P.2d 1053 (1981) (upholding a statute requiring the racing commission to recognize an agreement between permit holders regarding scheduling of races).

In Deer Mesa Corp. v. Los Tres Valles Special Zoning District, 103 N.M. 675, 712 P.2d 21 (N.M. App. 1985), the court invalidated a statute that permitted private individuals to create a special zoning district without any limitation on the size and location of the district. Again, the basis for the court's ruling was that there were no standards, not that all delegations of authority are per se invalid. Cf. State ex rel. Angel Fire Home and Land Owners Ass'n v. South Cent. Colfax County Special Hosp. Dist., 110 N.M. 496, 797 P.2d 285, *cert. denied*, 110 N.M. 330, 795 P.2d 1022 (N.M. App. 1990) (upholding a statute authorizing private persons petitioning for creation of a special hospital district to draw boundary lines for the district, because sufficient limitations and standards existed).

In the present case, the utility's right to reject a revenue sharing plan cannot be deemed to be a **delegation** of legislative power, because utilities already possess such a power, through the rule against retroactive rate making.

review delegated authority to the Utah State Barber Board, an organization composed of barbers in the state, to set minimum prices and other conditions of service for barbers in Utah. The Court found the statute unconstitutional because it authorized this private entity to establish a price schedule contrary to the public interest. The Court acknowledged that

the legislature may properly delegate to some administrative body the duty of ascertaining the facts upon which the provisions of the law are to function, and also, that one of the methods of initiating activity on the part of that administrative body may be by petition of the citizens concerned. Such procedure is not in and of itself defective as an improper delegation of legislative authority.

192 P.2d at 567.

Obviously, the fact that a utility may initiate a proceeding to consider an alternative form of rate regulation under Section 54-4-4.1 does not result in an unconstitutional delegation under the explicit language of Revne. In addition, the fact that a utility may opt out of a revenue sharing plan is hardly the equivalent of the utility setting its own prices and conditions of service, as the barbers did in Revne. If a utility opts out of a revenue sharing plan, the Commission would still have the authority to set the utility's rates and otherwise to regulate its service.⁴⁵ Unlike the situation in Revne, under Section 54-4-4.1, no utility may unilaterally set its own rates or terms of service; any plan of rate regulation must be approved by the Commission.

In Union Trust Co. v. Simmons, 116 Utah 422, 211 P.2d 190 (1949), also cited by Appellants, the Court held that a statute that required the consent of all other

⁴⁵ In fact, pursuant to that power, the Commission reduced U S WEST's rates by \$19.8 million as part of its order in this case. (R. 5481, Addendum B)

banks in a city before any bank could establish a branch in that city was an unconstitutional delegation of legislative power. The basis for the decision, which distinguishes that case from the one at bar, is that the statute allowed third party competitor banks to prevent an administrative agency from exercising its existing authority to approve branch banks. Thus the competitor banks, acting contrary to the public interest, could impose their will on the public by refusing to allow another bank to establish a branch. In the case at bar, on the other hand, the Commission retains authority to approve any revenue sharing plan. The veto power merely insures that a utility retains its existing constitutional right to assert the rule against retroactive ratemaking. Therefore, it is not an unconstitutional delegation of legislative power.

In a more recent case, Utah Technology Finance Corp. v. Wilkinson, 723 P.2d 406 (Utah 1986), this Court held that there was no unconstitutional delegation of legislative power, where the Legislature established a corporation to promote economic development through assistance to high technology businesses, funding it with \$1,000,000 of public money. This Court stated:

“Due respect for the legislative prerogative in law making requires that the judiciary not interfere with enactments of the Legislature where disagreement is founded only on policy considerations and the legislative scheme employs reasonable means to effectuate a legitimate objective.” [quoting from Baker v. Matheson, 607 P.2d 233 (Utah 1979)] “[A]cts of the Legislature are presumed constitutional, especially when dealing with economic matters based on factual assumptions.” [quoting from Rio Algom Corp. v. San Juan County, 681 P.2d 184 (Utah 1984)] It is only when a legislative determination of public purpose is so clearly in error as to be capricious and arbitrary that the judiciary should upset it. . . .

What is public purpose varies and changes with the times. . . . “The strong presumption of the act’s constitutionality will not be overcome

simply because the plaintiff's economic forecasts differ from those of the legislature." [quoting from Wilson v. Connecticut Product Development Corp., 167 Conn. 111, 355 A.2d 72 (1974)]

In the present case, Appellants' efforts are primarily motivated by their preference for a single economic theory: cost of service rate regulation. In Section 54-4-4.1, the Utah Legislature has recognized that other forms of utility regulation, including revenue sharing plans, may be appropriate for the changing times, especially in industries that are increasingly subject to competition. This Court should defer to the Legislature's effort, which is neither arbitrary nor capricious, to address current economic reality by permitting revenue sharing plans that are consistent with Title 54.

B. The power to reject a revenue sharing plan does not constitute a denial of due process.

Appellants cite no authority in support of their argument that a utility's power to reject a revenue sharing plan under Section 54-4-4.1(2) is a denial of their due process rights. (App. Brief at 65-67). Rather, they complain that the mere existence of a veto power "vests leverage in the utility regulated over every aspect of the ratemaking process," and that other parties do not also have a veto power. (App. Brief at 65, 66). Remarkably, Appellants claim that they were precluded from offering their preferred version of incentive ratemaking, although there is absolutely nothing in the record to show that they even attempted to file a proposed plan, much less that they were precluded from doing so.

Appellants' argument that all parties to a rate proceeding should be on equal footing (i.e., that all parties should have a veto power if the utility has one) is unpersuasive when considered in light of the fact that under a revenue sharing

plan, only the utility's earned revenue, received from the collection of lawful, tariffed rates—which would otherwise be protected by the rule against retroactive rate making—would be at risk. No other party to a rate proceeding, including Appellants, bears a similar risk under a revenue sharing plan. Hence it is appropriate that only the utility have power to reject a revenue sharing plan. Thus it cannot be a deprivation of due process or equal protection⁴⁶ for a utility alone to have the power to reject a revenue sharing plan.⁴⁷

VI. THIS COURT NEED NOT RULE ON THE SEVERABILITY ISSUE. NEVERTHELESS, IF SUBSECTION 2 OF SECTION 54-4-4.1 IS DECLARED UNCONSTITUTIONAL, THE ENTIRE STATUTE IS NOT UNCONSTITUTIONAL.

No sharing plan is in effect at this time. Indeed, no party (including Appellants) is taking the position that the Commission's plan should go into effect, whatever the Court's decision on the constitutional issues raised in this case. Appellants argue that the Commission plan would be resurrected by a decision invalidating Subsection 2 but not Subsection 1. However, Appellants further argue that the Commission plan should then be overturned on other grounds (App. Brief at 97-101). Respondents also take the position that the Commission's plan should not go into effect. Any decision to place a sharing plan into effect in the absence of Subsection 2 should be left up to the Commission in a

⁴⁶ Although Appellants mention equal protection (App. Brief at 66), they do not further develop an argument on this issue, probably because it is so apparent that in a rate proceeding, the utility's position is unique, and no other party is similarly situated.

⁴⁷ It may be observed that the Commission also has power to reject any proposed revenue sharing plan.

subsequent proceeding or on remand, at which time the Commission would have the opportunity to consider such a plan in the light of the fundamentally different legal premise that would be occasioned by the invalidation of Subsection 2. Given the unanimity of the parties to this proceeding that no plan is in effect or should go into effect, whatever the Court decides, there is no need for the Court to determine the severability issue.

However, in the unlikely event that Subsection 2 were struck down, Respondents do not agree that Subsection 1 would necessarily fall, because Subsection 1 is broader than Subsection 2. Subsection 1 authorizes the Commission to adopt any form of regulation consistent with Title 54, including sharing plans. Subsection 2, on the other hand, allows a utility to opt out of a sharing plan, but not other forms of regulation. As discussed in Section V.A, *supra*, the obvious purpose of that provision is to continue to protect the utility (in the absence of its consent) from a plan that would violate the rule against retroactive ratemaking. Thus, if Subsection 2 were struck down, no sharing plan that requires retroactive refunds of earnings could be put in place without the consent of the utility.

However, to the extent that the Commission, pursuant to Subsection 1, were to adopt a form of regulation that does not violate the rule against retroactive ratemaking and was in all other respects consistent with Title 54, there is no reason that an invalidation of Subsection 2 should prevent the Commission from taking such an action.

VII. APPELLANTS ARE NOT ENTITLED TO ATTORNEYS' FEES NOR COSTS FROM U S WEST.

A. Background.

Appellants intervened in the Commission proceeding in September 1990 on their own behalf and not in any kind of representative capacity.⁴⁸ In the Commission proceedings, Appellants made no indication of an intention to seek to recover costs and attorneys fees. Indeed, it was not until they filed their docketing statement with this Court that Appellants claimed a right to costs and attorneys fees⁴⁹ and it was not until their Brief was filed that Appellants disclosed that they were seeking attorney's fees from U S WEST. (App. Brief at 118-19). While citing several theories, Appellants rely on two exceptions to the general "American" rule that attorney's fees are awarded only when either a statute or contractual provision so authorize: (1) the "Substantial Benefits" rule and (2) the "Private Attorney General" doctrine. (App. Brief at 108-16).

For the reasons set forth hereafter, Appellants' request for costs and attorney's fees from U S WEST must be denied, whatever the outcome of Appellants' constitutional challenge.

⁴⁸ In their Petition to Intervene, Appellants alleged that "[e]ach of the petitioners uses the services of [U S WEST] . . . and each is vitally affected by the regulation plan used and rates charged by that entity in this state" and that "[t]he petitioners' legal and financial interests may be substantially affected by the proceedings in this matter." (R. 4135-36). The Order granting Appellants' intervention request makes it clear that they are intervening in their individual capacities and not on behalf of anyone else. (R. 4130-31). Appellants have done nothing to change their status.

⁴⁹ Appellant's Docketing Statement, at 10, 14.

B. Appellants' Claim for Attorney's Fees is Procedurally Flawed.

1. Appellants' Claim Fails to Meet the Basic Principles of Procedural Due Process.

Not only did Appellants claim attorney's fees from U S WEST for the first time in their Brief, they ask this Court to establish the amount of such fees and require U S WEST to pay them as a part of this case. In other words, without any of the fundamental protections of due process – such as notice, an opportunity to engage in discovery, the requirement that the claimant present evidence in support of their claim,⁵⁰ and an opportunity for U S WEST to present responsive evidence – Appellants ask this Court to assume that all of their factual allegations are true and require U S WEST to pay their attorney's fees. If their request were granted, it would constitute a gross violation of U S WEST's due process rights, rights which have been established by decisions of both the United States and Utah Supreme Courts. In Morgan v. United States, 304 U.S. 1, 18 (1938), the U.S. Supreme Court stated:

But a 'full hearing'—a fair and open hearing—requires more than that. The right to a hearing embraces not only the right to present evidence, but also a reasonable opportunity to know the claims of the opposing party and to meet them.

This Court recognizes the same principles. In Nelson v. Jacobsen, 669 P.2d 1207, 1212-13 (Utah 1983), this Court stated:

Timely and adequate notice and an opportunity to be heard in a meaningful way are the very heart of procedural fairness.

⁵⁰ Under Utah law, a party asserting a claim for attorney's fees has the burden of proof to support an award of attorney's fees by evidence in the record. See Section VII.C, *infra*.

....

To satisfy an essential requirement of procedural due process, a 'hearing' must be prefaced by timely notice which adequately informs the parties of the specific issues they must prepare to meet

"Due process" is not a technical concept that can be reduced to a formula with a fixed content unrelated to time, place, and circumstances. Rather, the demands of due process rest in the concept of basic fairness of procedure and demand a procedure appropriate to the case and just to the parties involved.

Since there was no request for attorney's fees below, and since the fundamentals of due process cannot be met through the briefing process the parties are currently engaged in, an award of attorney's fees by this Court would violate U S WEST's due process rights.⁵¹

2. **Appellants are Inappropriately Attempting to Invoke the Original Jurisdiction of the Court.**

Appellants' effort to invoke the jurisdiction of this Court is legally impermissible. Because the attorney's fees issue was not raised below, Appellants' effort to raise the issue for the first time on appeal is an inappropriate attempt to invoke the original jurisdiction of this Court. The extent of this Court's original

⁵¹ Furthermore, U S WEST and Appellants are not opposing parties in the same sense that a plaintiff and defendant in a civil suit are. By their nature, administrative hearings, like the one conducted in this case, do not place parties in the same kind of adversarial position vis-a-vis each other as adversarial proceedings in a court. It is axiomatic that, in order to pursue a claim for damages, a party must appropriately invoke the jurisdiction of the court from which the remedy is sought. In a legal action where damages are sought, a claimant has the duty to file a complaint under the Utah Rules of Civil Procedure that is sufficient to outline the factual basis and legal theory under which the claim is made. Unless one were to take the surreal position that these requirements are met by a single sentence in a Docketing Statement and an argument in a Brief, Appellants have utterly failed to meet these basic requirements.

jurisdiction is defined and limited by Article VIII, Section 3 of the Utah Constitution:

The Supreme Court shall have original jurisdiction to issue all extraordinary writs and to answer questions of state law certified by a court of the United States. The Supreme Court shall have appellate jurisdiction over all other matters to be exercised as provided by statute, and power to issue all writs and orders necessary for the exercise by the Supreme Court's jurisdiction or the complete determination of any cause.

(emphasis added). *Accord*, Utah Code Ann. § 78-2-2(2) and (3). Thus, the original jurisdiction of this Court extends only to questions of state law certified by a federal court and to the issuance of extraordinary writs. Obviously, a request for attorney's fees does not fall into either area.

In order for Appellants to have pursued an attorney's fees claim against U S WEST (or any other party) they should have challenged the constitutionality of the statute in the district court and raised the attorney's fee issue at that time.⁵² In the cases cited by Appellants, the attorney's fees claim was raised in the original lawsuit.⁵³ In none of the cases did the party seeking attorney's fees

⁵² Appellants could possibly have challenged the constitutionality of the statutes under the Declaratory Judgment Act, Utah Code Ann. § 78-33-1 et seq., or, in the event an unconstitutional sharing plan went into effect that was causing Appellants harm, they could have sued to have the plan declared invalid and to recover damages for themselves and potentially for all ratepayers pursuant to a class action under Rule 26, URCP. To the extent that Appellants could articulate a basis to support an award of attorney's fees they could have made it a part of the case. In that event, there would be a clear plaintiff and defendant, notice that such fees were being claimed, and an opportunity to present evidence. None of these attributes of due process are present in the current posture of the case.

⁵³ Arnold v. Dept. of Health Services, 775 P.2d 521, 523 (Ariz. 1989) (attorney's fees awarded by trial court); Citizens Against Rent Control v. City of Berkeley, 226 Cal. Rptr. 265, 268, 274 (Ct. App. 1986) (attorney's fees sought in remand proceedings; court noted that plaintiffs had sought attorney's fees in

attempt to invoke the original jurisdiction of the appellate court, as Appellants are attempting to do here.

3. Because Appellants Failed to Raise the Issue of Attorney's Fees Below, They are Precluded from Raising it on Appeal.

As Appellants acknowledge, the issue of attorney's fees was not raised below.⁵⁴ The Court of Appeals in Call v. City of West Jordan, 788 P.2d 1049 (Utah App. 1990), held that the failure to raise a request for attorney's fees at the trial court precluded a request for them on appeal. Appellants attempt to distinguish Call, claiming that all the exceptions to the rule against awarding attorneys fees are equitable in nature and cannot be asserted before an administrative agency. While that may be true, the fact is that any ground for appeal from an order of the Commission must be preserved in a petition for rehearing. Utah Code Ann. § 54-7-15(2)(b) states unequivocally that "no applicant may urge or rely on any ground not set forth in the application [for rehearing] in an appeal to any court."⁵⁵ This

amended complaint so that defendants were on notice of claim); Crawford v. Los Angeles Bd. of Education, 246 Cal. Rptr. 806, 808 (Ct. App. 1988) (attorney's fees awarded by trial court); D'Amico v. Board of Medical Examiners, 520 P.2d 10, 27 (Cal. App. 1974) (attorney's fees awarded by trial court); Mandel v. Hodges, 127 Cal. Rptr. 244, 247-48 (Ct. App. 1976) (attorney's fees awarded by trial court); Northington v. Davis, 593 P.2d 221, 222-23 (Cal. 1979) (attorney's fees awarded by trial court); Serrano v. Priest, 569 P.2d 1303, 1304 (Cal. 1977) (attorney's fees awarded by trial court).

⁵⁴ App. Brief at 117-118. In fact, in none of the pleadings or briefs filed by Appellants below, including Appellants' July 15, 1991 Motion for Rehearing, was there even a glimmer of an indication that they were seeking recovery of attorney's fees and costs.

⁵⁵ As noted in Section VII.B.1, *supra*, the failure of Appellants to raise the issue below is fatal for another reason: U S WEST was never given adequate notice that Appellants were asserting an attorney's fees claim against it. Now, on

Court, in Utah Associated Municipal Power Systems v. Public Service Commission, 789 P.2d 298, 300 (Utah 1990), recently reaffirmed the principle that “an issue is not preserved for consideration on appeal unless it has been specifically raised in a petition for rehearing before the PSC.” Appellants, by their own admission, failed to do so.

C. **Because Appellants’ Claim for Attorney’s Fees is Based on a Fundamental Factual Flaw, Appellants Have Failed to Meet Their Burden of Proof.**

In their Docketing Statement, Appellants stated the issue relating to their request for attorney’s fees this way:

Whether Petitioners are entitled to their attorney fees and costs for challenging the constitutionality of a statute and Commission Order which might cost the consumers of Utah millions of dollars in higher phone rates than they might otherwise pay if the Commission’s Order or the plan proposed by U. S. West is allowed to go into effect.

(App. Docketing Statement at 10; emphasis added). This statement either shows an incredible naivete on Appellants’ part or is a deliberate attempt to mislead the Court. The basic premise of Appellants’ claim is that their actions will save the ratepayers of Utah potentially millions of dollars in preventing either the Commission’s plan or U S WEST’s plan from taking effect.⁵⁶ In reality, Appellants are “saving” ratepayers from a non-existent threat.

appeal, U S WEST has no opportunity to engage in discovery or to present evidence on the issue. This deprives U S WEST of its basic due process rights to notice, discovery, and an opportunity to confront and respond to the evidence presented against it.

⁵⁶ Appellants claim that their appeal will result in “benefits to be realized . . . in the immediate future [which] largely reside in the realm of monies consumers of telephone service will not have to pay because of the Commission’s unconstitutional and unlawful order.” (App. Brief at 107).

Contrary to Appellants' inference, U S WEST's plan was definitively rejected by the Commission. (R. 5469-77). Furthermore, no party asserts that the Commission plan is in effect. U S WEST opted out of the plan (R. 5692-93) and no other party claims that it is or should be in effect, including Appellants. Thus, Appellants' claim that their action will save ratepayers millions of dollars has absolutely no basis in fact.

Furthermore, even if the Commission plan were in effect, there is no basis for a factual conclusion that the plan will cost consumers millions of dollars. An examination of the Commission plan shows that the Commission retained full authority to terminate the plan, whenever it determined that it was not operating in the public interest. (R. 5479, ¶ 7, Addendum B). Thus, the acceptance by this Court of Appellants' assertion that the Commission's plan will cost ratepayers millions would be inappropriate. The plan is not in effect, and even if it were, there is no factual basis to conclude that it would harm ratepayers.

A party claiming attorney's fees bears the burden of proof to establish the award. Commerce Financial v. Markwest Corp., 806 P.2d 200, 204 (Utah App. 1990); Jones v. Muir, 515 A.2d 855, 859 (Pa. 1986). Such "an award . . . must be supported by evidence in the record." Dixie State Bank v. Bracken, 764 P.2d 985, 988 (Utah 1988), Sprouse v. Jager, 806 P.2d 219, 226 (Utah App. 1991). The factual basis for Appellants' claim has simply not been demonstrated. In fact, Appellants placed no evidence in the record below either as to the factual basis for their claim for attorney's fees or the amount of such fees. They have therefore failed to meet their burden of proof.

D. Neither of the Two Theories Relied Upon by Appellants – Substantial Benefit or Private Attorney General – Has Been Adopted in Utah.

In a long line of cases regarding attorney's fees, this Court and the Court of Appeals have adopted the "American" rule: "In Utah, attorney fees are awarded only if authorized by statute or by contract." E.g., Dixie State Bank v. Bracken, 764 P.2d 985, 988 (Utah 1988); Mountain States Broadcasting v. Neale, 776 P.2d 643, 648 (Utah App. 1989); Cobabe v. Crawford, 780 P.2d 834, 836 (Utah App. 1989); Govert Copier Painting v. Van Leeuwen, 801 P.2d 163, 173 (Utah App. 1990).

In the federal arena and in some states, courts have recognized some equitable exceptions to the American rule. A commonly accepted exception is the so-called "common fund" rule. Under that rule, attorney's fees have been awarded "to the successful plaintiff when his representative action creates or traces a common fund, the economic benefit of which is shared by all members of the class." Hall v. Cole, 412 U.S. 1, 5 n.7 (1973). Under the common fund doctrine there must be an identifiable fund from which the fees are paid and the beneficiaries must be easily identifiable. Aleyeska Pipeline Co. v. Williams Society, 421 U.S. 240, 264-65, n. 39 (1975); Boeing Co. v. Van Genert, 444 U.S. 472, 479 (1980). This exception has been adopted in numerous state jurisdictions,⁵⁷ although not in Utah.⁵⁸ Appellants do not rely on the "common fund" theory, recognizing that

⁵⁷ E.g., Hamer v. Kirk, 356 N.E. 2d 524, 528 (Ill. 1976); Van Emmerik v. Montana Dakota Utilities Co. 332 N.W. 2d 279, 282, (S.D. 1983); Jones v. Muir, 515 A.2d 855, 858 (Pa. 1986); Shelby County Comm'n v. Smith, 372 So.2d 1092, 1096-97 (Ala. 1979) Dennis v. State, 451 N.W. 2d 676, 687-88 (Neb. 1990).

⁵⁸ Appellants' assertion (App. Brief at 106) that this Court adopted the "common fund" exception in Plumb v. State, 809 P.2d 734 (Utah 1990) is a gross mischaracterization. Plumb involved a review of the level of the District Court's

there is no fund (App. Brief at 107-08).

Another common exception to the American rule that has been adopted by many courts is the “bad faith” exception:

[I]t is unquestioned that a federal court may award counsel fees to a successful party when his opponent has acted ‘in bad faith, vexatiously, wantonly, or for oppressive reasons!’”

Hall v. Cole, *supra*, 421 U.S. at 5. This exception has been statutorily adopted in Utah.⁵⁹ Appellants do not rely on this exception either.

Neither the “substantial benefit” nor the “private attorney general” exception – the exceptions relied upon by Appellants – has been adopted in Utah.

E. Even If the Substantial Benefit Doctrine Had Been Adopted in Utah, It Does Not Support Appellants’ Claim.

The “substantial benefit” rule is an extension of the common fund rule – the major difference is that under the substantial benefit rule, no defined fund is necessary. Appellants rely on the “substantial benefit” rule in support of their attorney’s fees claim. (App. Brief at 108-09). A reading of Appellants’ principal case, Serrano v. Priest, 569 P.2d 1303 (Cal. 1977) and other authorities related to

award of attorney’s fees in the thrift settlement. The basis for the attorney’s fees award was a written agreement between the class representative and class counsel and was not based upon the “common fund” exception to the American rule. The only reference to “common fund” in the Court’s opinion was obviously not for the purpose of adopting the exception. *Id.* at 740. This Court in Turtle Management v. Haggis Management, 645 P.2d 667, 671 n. 1 (Utah 1982) made it clear that it has not ruled on this exception.

⁵⁹ Utah Code Ann. § 78-27-56 (Supp. 1991).

this rule demonstrates that Appellants' reliance on this theory is utterly misplaced.⁶⁰

Appellants grossly misrepresented the "substantial benefits" rule in their Brief. They quote Serrano for the proposition that the rule permits "the award of fees when the litigant, proceeding in a representative capacity, obtains a decision resulting in the conferral of a 'substantial benefit' of a pecuniary or non-pecuniary nature." 569 P.2d at 1309 (App. Brief at 108). They failed, however, to quote the next sentence from Serrano:

In such circumstances, the Court, in the exercise of its equitable discretion, thereupon may decree that under the dictates of justice **those receiving the benefit should contribute to the costs of its production.**

569 P.2d at 1309 (emphasis added). Thus, Appellants failed to mention a major part of the substantial benefits rule: that it is the beneficiaries of representative's actions who pay the fees. All courts that have adopted the "substantial benefit" rule make it clear that the fees are to be paid by those who benefit. The seminal case is Mills v. Electric Auto-Lite Co., 396 U.S. 375 (1970). Mills was a derivative action brought by minority shareholders to set aside a merger based on a misleading proxy statement. In Mills, the Court upheld an award of attorney's fees from the corporation on the basis of the substantial benefit rule which permits

reimbursement in cases where the litigation has conferred a substantial benefit on members of an ascertainable class, **and where**

⁶⁰ Not all courts have adopted the "substantial benefit" rule. For example, in Hamer v. Kirk, 356 N.W. 2d 524, 528 (Ill. 1976), the Illinois Supreme Court ruled that "in the absence of a fund, a plaintiff's attorney is not entitled to attorney's fees merely because he has conferred a benefit upon members of a class."

the court's jurisdiction over the subject matter of the suit makes possible an award that will operate to spread the costs proportionately among them.

Id. at 393-94 (emphasis added). Thus, the substantial benefit rule requires (1) the conferral of a benefit to a class that can be readily identified and (2) the court must be in a position to spread the attorney's fees proportionately among the class. *Accord*, Hall, *supra*, 412 U.S. at 5-7, Doe v. State, 579 A.2d 37, 48-49 (Conn. 1990); Jones v. Muir, 515 A.2d 855, 860-61 (Pa. 1986); Van Emmerik v. Montana Dakota Utilities Co., 332 N.W. 2d 279, 283-84 (S.D. 1983).

In applying this rule, the courts in other states have consistently rejected efforts to recover fees from parties who are not beneficiaries of the class representative's acts. For example, in Doe, a class action resulted in an injunction against state officials from restricting payment for abortions for indigent women. The plaintiffs appealed from a trial court ruling denying them attorney's fees. Plaintiffs claimed attorney's fees from the state on the basis that they had benefited all poor women in the state. The Connecticut Supreme Court rejected plaintiffs' request for attorney's fees, concluding that "the plaintiffs' have not conferred a substantial benefit upon all those whom they seek to impose the financial burden of their counsel fees." 579 A.2d at 49. In an effort to avoid the conclusion that a benefit had not been conferred upon all the citizens of Connecticut, plaintiffs (much like Appellants in this case) argued that they "have conferred a benefit upon all citizens of this state by challenging unconstitutional actions by the state." The court rejected this claim, stating that it would expand the substantial benefit doctrine "beyond its underpinnings." *Id.* In Van Emmerik, plaintiff sought to

recover attorneys fees from utility companies who had collected sales taxes pursuant to a sales tax statute that was later invalidated. The trial court denied the request. On appeal, the South Dakota Supreme Court affirmed, pointing out that "we see no benefit accruing to the utilities as a result of appellant's law suit." 332 N.W. 2d at 283.

In this case, Appellants seek attorney's fees from U S WEST. Yet, in their argument they assert that if they are successful in their appeal "they will have conferred a substantial benefit **upon the ratepayers of U.S. West and a potential benefit upon all the ratepayers of other rate regulated natural monopoly utilities in this State who may have sought similar treatment.**" (App. Brief at 109; emphasis added). Nowhere do the Appellants claim that their appeal is in the best interest of or for the benefit of U S WEST. Thus, Appellants have failed to meet one of the basic elements of the "substantial benefit" rule.⁶¹ Likewise, they fail to meet the requirement that they be operating in a representative capacity. This is not a class action; further, Appellants' Petition to Intervene makes it clear that they entered the case to protect their own financial interests.⁶²

While the substantial benefit rule has not been adopted in Utah, Appellants,

⁶¹ If Appellants were to seek attorney's fees from all ratepayers, they would fail under another aspect of the "substantial benefits" rule, which requires that "the classes of beneficiaries [be] small in number and easily identifiable [so that] there was reason for confidence that the costs could indeed be shifted with some exactitude to those benefitting." *Aleyeska, supra*, 421 U.S. at 265, n. 39. *Jones v. Muir, supra*, 515 A.2d at 861 (denying attorney's fees under substantial benefit rule on the ground that the benefits "were supposed to accrue to the general public."); *Doe v. State, supra*, 579 A.2d at 49.

⁶² See footnote 48, *supra*.

as a matter of law, would not meet the requirements of the rule even if it had been adopted in Utah.

F. **The Private Attorney General Doctrine is Clearly the Minority Rule in the United States and Should be Rejected by this Court.**

The second theory upon which Appellants rely is the “Private Attorney General” doctrine. Under this rule, attorney’s fees can be awarded to a litigant where the litigant is forced to step in and litigate an important societal interest that broadly benefits the public. The leading case in favor of the doctrine is Serrano v. Priest, 569 P.2d 1303, 1312-16 (Cal. 1977).

1. **Appellants Have Failed to Meet Their Burden of Establishing the Elements of the Private Attorney General Theory in this Case.**

As will be discussed below, this doctrine, unlike the common fund and substantial benefit rules, has not been widely adopted by the courts in this country – it remains in the distinct minority. Nevertheless, assuming *arguendo* that it were the law of Utah, it is clear that Appellants have failed to meet their burden in demonstrating its elements in this case.

In order to meet the rule, three distinct factors must be satisfied:

(1) the strength or societal importance of the public policy vindicated by the litigation, (2) the necessity for private enforcement and the magnitude of the resultant burden on the plaintiff, (3) the number of people standing to benefit from the decision.

Serrano, 569 P.2d at 1314. Appellants claim that the first element is met because they are vindicating important statutory and constitutional rights. Yet, it is undisputed that no sharing plan will go into effect, whatever the Court’s decision on the constitutionality of Section 54-4-4.1. Thus, at this point, the constitutional

issues are of purely academic interest. In light of that fact, it would be impossible to conclude that a matter of great societal importance hangs in the balance.

With regard to the second factor – the necessity of private enforcement and the burden on Appellants – Appellants claim that the public authorities (the Commission, Division and Committee) actively failed to undertake their duty of challenging the statute and that Appellants were therefore forced to bring their appeal. What they fail to take into account is the fact that the Commission, based on what it considered good authority, did not feel it appropriate for it to determine the constitutionality of a statute granting it powers. (R. 5059-62). Further, both the Division and Commission believe the statute is constitutional. And, while the Committee raised questions as to the constitutionality of the opt out provision (R. 4806-10), it also opposed incentive regulation in general (R. 5136-54). Since no incentive or sharing plan is or will be in effect, the Committee apparently did not feel it necessary to appeal. The fact is that there is no necessity for private enforcement since, even under Appellants' view of proper rate regulation, nothing injurious to the public can result from this case. If U S WEST or another utility in the future seeks a sharing plan under the statute, there will be every opportunity for the issues raised by Appellants to be considered.

The third element – the number of people standing to benefit – fails for the same reason. Nothing that results from this case will put ratepayers in Utah in any different position than they are now in, since U S WEST is currently subject to traditional regulation.

2. **The Private Attorney General Doctrine Should Not be Adopted in Utah.**

In 1976, the United States Supreme Court strongly rejected the private attorney general doctrine in Aleyeska Pipeline v. Wilderness Society, 421 U.S. 240 (1976). In 1977, California accepted the doctrine in Serrano. In the sixteen years since Aleyeska and Serrano, only four jurisdictions – Arizona, Idaho, Wisconsin and Oregon – have adopted the private attorney general doctrine.⁶³ During that same period, decisions in eight states – Washington, Connecticut, Massachusetts, Illinois, South Dakota, Pennsylvania, Rhode Island and Alabama – expressly rejected the doctrine.⁶⁴

In Aleyeska, a group of environmental organizations sued to prevent the issuance of permits for construction of a pipeline in Alaska. Although subsequent legislation rendered their effort unsuccessful, they were awarded attorney's fees on the theory that they had protected substantial public interests. On appeal, the U.S. Supreme Court rejected that theory. The Court noted that Congress, while

⁶³ Arnold v. Arizona Dept. of Health, 775 P.2d 521 (Ariz. 1989); Hellar v. Cenarrusa, 682 P.2d 524 (Id. 1984); Watkins v. Labor & Indus. Review Comm'n, 345 N.W. 2d 482 (Wisc. 1984); Umrein v. Heimbigner, 632 P.2d 1367 (Ore. App. 1981).

⁶⁴ Blue Sky Advocates v. State, 727 P.2d 644, 648-49 (Wash. 1986); Doe v. Heintz, 526 A.2d 1318, 1322-23 (Conn. 1987); Doe v. State, 579 A.2d 37, 48 (Conn. 1990); Pearson v. Board of Health, 525 N.E. 2d 400 (S.Ct. 1988); Hamer v. Kirk, 356 N.E. 2d 524, 527-28 (Ill. 1976); Van Emmerik v. Montana Dakota Utilities Co., 332 N.W. 2d 279, 284 (S.D. 1983); Jones v. Muir, 515 A.2d 855, 861 (Pa. 1986); Providence Journal Co. v. Mason, 359 A.2d 682, 688 (R.I. 1976); Shelby County Comm'n v. Smith, 372 So. 2d 1092, 1096-97 (Ala. 1979). In addition, courts in Colorado and Nebraska have cited with general approval cases rejecting the private attorney general doctrine. People v. District Court, 808 P.2d 831, 835 (Colo. 1991); Dennis v. State, 451 N.W. 2d 676, 687-88 (Neb. 1990).

recognizing the American rule, has made

specific and explicit provisions for the allowance of attorney's fees under selected statutes granting or protecting various federal rights. . . . Under this scheme of things, it is apparent that the circumstances under which attorney's fees are to be awarded and the range of discretion of the courts in making those awards **are matters for Congress to decide.**

421 U.S. at 260, 262 (emphasis added). The Court was particularly impressed by the fact that Congress had "carved out" numerous statutory exceptions to the general American rule. In light of that fact, the Court concluded that the federal courts

are not free to fashion drastic new rules with respect to the allowance of attorney's fees to the prevailing party in federal litigation or to pick and choose among plaintiffs and the statutes under which they sue and to award fees in some cases but not in others, depending upon the courts' assessment of the importance of the public policies involved in particular cases.

Id. at 269. On this basis, the Court concluded that "it is not for us to invade the legislature's province by redistributing litigation costs in the manner suggested by respondents" *Id.* at 271.

Likewise, the Utah legislature has adopted specific and explicit statutes allowing attorney's fees in a variety of situations.⁶⁵ Among these statutes are the

⁶⁵ *E.g.*, Utah Code Ann. §§ 7-15-1(3) (Supp. 1991) (bad checks); 13-11-17.5 (Supp. 1991) (consumer sales practice); 13-11a-4(2)(c) (Supp. 1991) (truth in advertising); 13-14a-7 (Supp. 1991) (equipment repurchase from retail dealers); 13-15-6(3) (Supp. 1991) (business opportunity disclosure documents); 13-16-7(3) (Supp. 1991) (motor fuel marketing practices); 13-23-7 (Supp. 1991) (health spas); 13-24-5 (Supp. 1991) (trade secrets); 14-2-1 & 2 (Supp. 1991) (suit under bond – failure to obtain bond); 31A-15-108 (1991) (action against unauthorized insurer); 34-27-1 (1988) (suit for wages); 34-28-13 (1988) (assignment of wage claims); 38-1-18 (1988) (enforcement of mechanic's liens); 45-3-5 (1988) (action for abuse of personal identity); 57-11-17(2) (1990) (land sales practices); 57-15-9 (1990) (security interests in real estate); 57-22-6(3)(e) (Supp. 1991) (unfit premises); 62A-11-410(2) (1989)

provisions that codify the “bad faith” exception to the American rule, Utah Code Ann. § 78-27-56, and that allow attorney’s fees in suits brought against peace officers and other governmental employees for violations of the Fourth Amendment of the U.S. Constitution. *Id.* § 78-16-3. Thus, the rationale underlying the Aleyeska decision applies directly in Utah. The Utah legislature has acted in a variety of situations to statutorily allow an award of attorney’s fees to protect various state rights. Appellants, who can cite no statute allowing the recovery of attorney’s fees in this type of case, are thus asking this Court to “invade the [Utah] legislature’s province” and redistribute litigation costs.

Each of the state decisions rejecting the private attorney general doctrine has explicitly agreed with the rationale articulated in Aleyeska. For example, in Doe v. Heintz, the Connecticut Supreme Court stated:

In view of this legislative policy of selecting the special situations where attorneys’ fees may be awarded, we agree with the trial court that it is inappropriate for the judiciary to establish under the private attorney general doctrine a broad rule permitting such fees

526 A.2d at 1323. In Blue Sky Advocates, the Washington Supreme Court cited language from Aleyeska and stated that “[w]e are convinced of the wisdom of this reasoning for our state system and adopt it.” 727 P.2d at 649. In Shelby County, the Alabama Supreme Court responded to Serrano by stating that “[w]e, however, are not inclined to make such a drastic change in Alabama law and overrule such

(failure to withhold child support); 63-30c-1 *et seq.* (1989) (recovery by public officers of attorney’s fees for defense of actions under Article V); 70C-7-204 (1990) (violation of Consumer Credit Act); 76-9-406 (1990) (violation of privacy offenses); 78-11-10 (1987) (actions against peace officers); 78-16-3 (1987) (actions for 4th Amendment violations); 78-27-56 (Supp. 1991) (actions or defense in bad faith); 78-37-9 (1987) (mortgage foreclosures).

a clear line of precedent without legislative authorization.” 372 So. 2d at 1097.

Respondent U S WEST submits that the rationale of Aleyeska, particularly in light of the broad ranging state statutes allowing attorney’s fees in a variety of situations, should be followed by this Court, since it maintains an appropriate balance between the judicial and legislative branches of government.

G. Appellants Have Failed to Articulate Any Rational Basis for a Claim of Attorney’s fees Against U S WEST.

The sole basis for Appellants’ claim that U S WEST should pay Appellants’ attorney’s fees is contained in these two sentences:

The practical problem with determining who should pay Appellants’ costs and attorney’s fees is also easily resolved in this case. They should be paid by the major proponent of this unconstitutional statute, U.S. West.

App. Brief at 118-19.⁶⁶ If the implications of this statement were not so serious, the claim would be laughable.

Appellants cite no authority to support their claim for attorney’s fees on the theory that favoring a piece of legislation renders one legally liable to someone who later challenges the legislation.⁶⁷ They do not address the bizarre chilling impact that such a standard of liability would have on the fundamental democratic right of citizens – including corporations – to seek legal change through legislative action. They ignore the fact that the plan proposed by U S WEST was rejected by the Commission and that the plan ultimately adopted by the Commis-

⁶⁶ Those two sentences comprise the entirety of Appellants’ “case” against U S WEST for attorney’s fees.

⁶⁷ It is virtually unimaginable that any court has ever imposed liability on a party on the ground that they favored a piece of legislation.

sion was as unacceptable to U S WEST as it is to Appellants.

It is a fundamental principle of Utah law that a party seeking damages from another party must articulate a legally cognizable basis for the relief sought. By any standard, Appellants have failed to do so. Their claim for costs and attorney's fees should therefore be rejected.

VIII. THE COMMISSION'S FINDING OF A RATE OF RETURN ON EQUITY OF 12.2% WAS SUPPORTED BY SUBSTANTIAL EVIDENCE.

Appellants presented no testimony dealing with rate of return nor did they (or their counsel, Mr. Barker) participate in the hearings held in December 1990, when the rate of return witnesses for U S WEST, the Division and the Committee were cross-examined. (R. 531, 695). Despite their non-participation on this issue, Appellants attempt to overturn the Commission's finding of a 12.2% return on equity, claiming it is not based on substantial evidence.

A. Appellants failed to marshal the evidence in support of a 12.2% rate of return.

The sole ground for Appellants' attack on the Commission's rate of return finding is their claim that "the Commission's adoption of a 12.2% rate of return is unsupported by substantial evidence." (App. Brief at 101). Under the Utah Administrative Procedures Act (UAPA), the reviewing court can grant relief if the Appellant has been substantially prejudiced by an action of the agency that "is based upon a determination of fact, made or implied by the agency, that is not supported by substantial evidence when viewed in light of the whole record before the court." Utah Code Ann. § 63-46b-16(4)(g). While the substantial evidence test

of the UAPA grants courts greater latitude than prior standards, Grace Drilling Co. v. Board of Review, 776 P.2d 63, 67 (Utah App. 1989), it also imposes greater duties upon a party seeking to challenge the agency's finding:

It is also important to note that the "whole record test" necessarily requires that a party challenging the Board's findings of fact must *marshall* all of the evidence supporting the findings and show that despite the supporting facts, and in light of the conflicting or contradictory evidence, the findings are not supported by substantial evidence.

Id. at 68 (italics in original). *Accord*, First Nat'l Bank v. County Board of Equalization, 799 P.2d 1163, 1165 (Utah 1990) ("party challenging the findings . . . must marshall all of the evidence supporting the findings"); West Valley City v. Majestic Investment Co., 818 P.2d 1311, 1315 (Utah App. 1991).

Appellants did not marshall the evidence in this case relating to the rate of return issue. While Appellants filed a 121 page brief, their treatment of the rate of return is scant. They dedicate only one paragraph to it in their fact section and less than four pages to it in their argument,⁶⁸ despite the fact that the four witnesses who addressed the rate of return issue filed 600 pages of testimony and exhibits (R. 5976-6012, 6013-22, 6595-6607, 6612-6735, 7041-71, 7307-7510, 7512-7780) and the transcript of their cross-examination extended for over 400 pages. (R. 530-941) In addition, U S WEST, the Division and Committee filed extensive post hearing briefs. (R. 4714-59). Despite this voluminous record, there is not a single

⁶⁸ App. Brief at 51-52, 101-05.

reference to the factual record in Appellants' argument.⁶⁹ Thus, Appellants have not even attempted to meet their duty of marshalling the evidence. Instead, as Appellants acknowledge, their entire argument is based on a facial analysis of the Commission's order. This is how Appellants characterized their challenge in this manner:

Once again, the Commission's Report and Order – **on its face** — demonstrates that there was no record evidence to support a finding of a 12.2% rate of return.

App. Brief at 102 (emphasis added). Appellants have utterly misperceived their duty in challenging a finding based on lack of substantial evidence. The question is not whether the Order "on its face" sets forth sufficient evidence to support the finding; rather, the question is whether there is sufficient evidence **in the record** to support the finding. In failing to marshal the evidence on this issue, Appellants' challenge to the rate of return finding must fail, particularly in the face of the principle that a failure to marshal causes the challenged finding to be treated as conclusive:

If indeed [appellant] is challenging the finding that she was terminated for a failure to adhere to the store's coupon policy, **she has failed to meet her burden of marshaling the evidence in support of that finding. Therefore, we accept the Board's finding as conclusive.**

Nelson v. Dep't of Employment Security, 801 P.2d 158, 161 (Utah App. 1990) (emphasis added); Merriam v. Board of Review, 812 P.2d 447, 450 (Utah App. 1991);

⁶⁹ See App. Brief at 101-05. In their argument on this issue, Appellants quote the Order five times and never cite the factual record. That is the full extent of their effort to persuade the Court that the 12.2% return is not "supported by substantial evidence when viewed in light of the whole record before the court."

Pro-Benefit Staffing v. Board of Review, 775 P.2d 439, 441 (Utah App. 1989).

Because Appellants failed to marshal the evidence, the Commission's finding of 12.2 percent return on equity must be treated by this Court as conclusive.

B. There is substantial evidence in the record to support a 12.2% rate of return.⁷⁰

1. Appellants' Analysis is Misleading and Flawed.

Appellants' challenge to the Commission's rate of return finding is based solely on a facial review of the order rather than a substantive review of the evidence presented.

Appellants' discussion of the Commission's 13 page analysis of rate of return (R. 5397-5409, Appendix 1) is highly selective and completely misleading:

- Appellants point out the Commission's statement that U S WEST has been able to raise capital at an 11.8 percent rate of return and that capital costs had been trending downward (App. Brief at 102).
- Appellants attribute the Commission's finding of a rate of return higher than 11.8 percent as being based on an unsubstantiated finding that conditions in the industry and the economy are unsettled in the near term. (*Id.* at 102-03).
- Based solely on the Commission's statement that "[t]his is a time when states are in a sense competing for high-tech additions to and

⁷⁰ The Division takes the position that the Commission's finding of a 12.2% rate of return is supported by substantial evidence. However, the Division did not participate in this portion of the Brief.

refinements of telecommunications plant and equipment" (R. 5409, App. 1), Appellants assert that the Commission's decision to raise the rate of return from 11.8% to 12.2% is a regulatory bribe made to persuade U S WEST to invest more in the telecommunications infrastructure in Utah. (*Id.* at 103-04).

What is most amazing about Appellants' argument is what they did not mention. There is not a single reference to any of the models used to estimate costs of capital, such as the discounted cash flow model (DCF) and the capital asset pricing model (CAPM). Yet, the Commission's Order discusses these issues at length. (R. 5402-08, Addendum B). And, while Appellants profess outrage that the Commission raised the rate of return, they fail to mention, let alone discuss, the specific reasons that the Commission gave for doing so:

Without dispute, capital costs have declined since the previous rate of return decision of 11.8 percent, and even since the filing of direct testimony. Taken alone, this would argue for reduction in allowed return. **But other compelling factors have a role to play.** The record on risk-return comparability, while not complete, on balance suggesting increasing risk; the questioned reliability of model results during unsettled moments in the economy and industry; the large, even contrary, difference in results obtained by witnesses for the Company compared with witness Compton for the Division using CAPM; the knowledge that the utility may to a degree be shedding certain utility characteristics; and the ambiguous record on expected behavior of stock price, are all influential considerations which must be evaluated in the context of a wide range of cost of equity results obtained by witness application of models. The Commission concludes there is no reason to grant an award at the upper end of the range, and indeed there are reasons why this would be error. The Commission is convinced a reduction in the current equity return, though advocated by witnesses for the Committee and the Division, would likewise be in error, given the risk implications of the changing industry and the status of the general economy in relation thereto.

R. 5407-08, Addendum B; emphasis added. Thus, contrary to Appellants' inference, the Commission did not just arbitrarily raise the return. Instead, the Commission examined a variety of results produced by several different models, relying primarily on the DCF model. It looked at conditions in the economy and in the industry and the fact that U S WEST "may to a degree be shedding certain utility characteristics." On balance, the Commission chose to establish a rate of return that was neither at the top of the range proposed by U S WEST's witnesses — 14.5 to 15 percent — nor at the bottom of the range suggested by other witnesses — 11.1 to 11.6 percent.

As to the assertion that the rate of return finding is a regulatory bribe, Appellants' reading of the Order ignores all other reasons cited by the Commission. Their argument is a cynical effort to attribute motives to the Commission that the order does not bear out. All the Commission was saying is that there is a relationship between rate of return and investment decision making, and that this relationship, along with other relevant considerations, should be considered in deciding the rate of return issue. (R. 5409, Addendum B). If, as Appellants infer, the Commission raised the rate of return to "bribe" U S WEST to invest more in Utah, one can only wonder why the Commission in the same order mandated that U S WEST place a fiber backbone system and modernize 41 central offices. (R. 5460-62, Addendum B). Obviously, the Commission did not believe it needed to bribe U S WEST to make investments the Commission considers necessary.

2. Substantial Evidence Supports the Commission's Finding.

While it is Appellants' burden to marshal all of the evidence supporting the

finding, even a cursory review of the evidence demonstrates that the Commission's rate of return finding is supported by substantial evidence.⁷¹

Consider first of all the DCF evidence. All witnesses presented DCF analyses. U S WEST witness Cummings presented several DCF analyses. His DCF analysis of U S WEST alone produced a calculated rate of return of 12.2% — an analysis of all seven Regional Holding Companies (RHCs)⁷² produced a 12.8% return (R. 7562-71, 7590, 7640). Using independent telephone companies, Mr. Cummings' DCF analysis resulted in a calculated rate of return of 14.3%; using comparable non-regulated companies, his DCF result was 15.2%. (R. 7567, 7641-42). Dr. Morin, another witness sponsored by U S WEST, obtained a DCF calculated rate of return for the RHCs of 13.11%, 13.74% for both independent telephone

⁷¹ Although there is no precise definition of substantial evidence, it is clear that it is more than a "scintilla" and less than a preponderance. Grace Drilling Co. v. Board of Review, 776 P.2d 63, 67-68 (Utah App. 1989); First Nat'l Bank v. County Bd. of Equalization, 799 P.2d 1163, 1165 (Utah 1990) (defines "substantial evidence" as the "quantum and quality of relevant evidence that is adequate to convince a reasonable mind to support a conclusion").

⁷² The RHCs are the seven companies created to provide local exchange services following the AT&T divestiture. U S WEST, Inc., the parent company of Respondent U S WEST Communications, Inc., is one of them. The seven RHCs are engaged in similar business activities, have similar bond ratings, size and capital structure and are subject to similar economic and regulatory risks. (R. 7370-71, 7422, 7424-25). Dr. Marcus, the Committee witness, pointed out that the RHCs are the most comparable companies to U S WEST (R. 883-84). U S WEST took the position that it was inappropriate for the Commission to base its finding of U S WEST's return on a single company rate of return, particularly in light of the Supreme Court decision in the Hope and Bluefield cases that emphasize the need for setting a return at levels earned by "other enterprises having corresponding risks." Federal Power Commission v. Hope National Gas Co., 320 U. S. 591, 603 (1944); Bluefield Water Works & Improvement Co. v. Public Service Comm'n, 262 U. S. 679 (1923). The Hope and Bluefield cases have been expressly followed by this Court in Utah Power & Light Co. v. Public Service Commission, 107 Utah 155, 152 P.2d 542 (1944).

companies and gas distribution utilities and 14.92% for high-quality industrials. (R. 7342-81, 7424-30). Dr. Compton, the Division's witness, took an approach that looked only at U S WEST, rather than comparing it to other companies. He found a 12.2% return for U S WEST, Inc., parent of Respondent U S WEST Communications, Inc., which he then reduced to reflect what he perceived to be less risk for U S WEST Communications, Inc., the regulated entity. He ultimately proposed an 11.5% return on equity (R. 6731, 7053-60). However, when doing an analysis of the RHCs, Dr. Compton produced an RHC average DCF calculated rate of return of 12.5%. (R. 7054). Like Dr. Compton, Dr. Marcus (the witness for the Committee) did a DCF analysis of U S WEST, Inc. that supported his recommendation of a rate of return of 11.3% for the regulated entity, although he also did an analysis of the DCF of the RHCs, which he estimated at 12.3% (R. 884).

In addition, the Division presented an exhibit (R. 6653), showing the comparative DCF rate of return results for PacifiCorp, the parent of Utah Power and Light, Questar, the parent of Mountain Fuel, and U S WEST, Inc., the parent of Respondent U S WEST Communications, Inc. The record showed that the rate of return found by the Utah Commission for both Utah Power and Mountain Fuel was 12.1%. (R. 866). The exhibit showed that the relative DCF calculated rates of return for the three companies were: PacifiCorp at 10.7%, Questar at 11.1% and U S WEST, Inc. at 11.9%. (R. 6633). Thus, comparing U S WEST to the other major regulated utilities in Utah, its required return was higher. Since the commission had set the return on equity for Mountain Fuel and Utah Power at 12.1% as recently as 1991, it is entirely consistent with the evidence that it set U S

WEST's return at a higher level, in this case a modest increase to 12.2%. The point is that there is a wealth of DCF evidence that supports a finding of a rate of return from 11.3% to over 14%. The Commission's finding falls well within that range.

In addition to the DCF testimony, there was considerable testimony regarding the changes in the industry and to U S WEST that impact its risk. (R. 7334-35, 7338-41, 7393, 7546-50). Another U S WEST witness testified as to the uncertain nature of the United States economy and U S WEST's financial prospects (R. 7302). Dr. Morin testified at length regarding the problems of relying on a single methodology – such as DCF – in estimating rate of return, particularly in unsettled economic times (R. 7347-48). Both he and Mr. Cummings presented other approaches (R. 7382-88, 7431-33, 7572-81, 7643-48), whose calculations resulted in rate of return estimates well above 12.2%.⁷³

While the foregoing represents only a portion of the evidence presented on rate of return, it demonstrates beyond question that the Commission's finding is based on substantial evidence in the record.

CONCLUSION

Respondents respectfully request that the Court:

1. Dismiss the issues raised in Points I-IV and VI of Appellants' Brief

⁷³ While the Commission showed a clear preference for the DCF approach, it did not reject the other approaches. Indeed, one of the reasons cited by the Commission for its 12.2% finding was that a variety of considerations "must be evaluated in the context of a wide range of cost of equity results obtained by witness application of models." (R. 5408, Addendum B).


on the ground that they are moot or, in the event the Court does not dismiss these points on mootness grounds, Respondents request that the Court determine that both subsections of Section 54-4-4.1 are constitutional and deny Appellants' requests for costs and attorney's fees.

2. Affirm the Commission's finding that a 12.2 percent return on equity is reasonable.

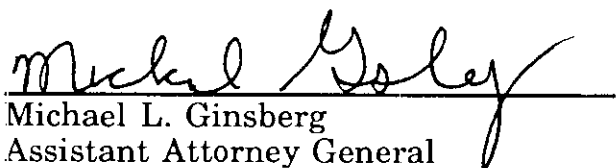
Respectfully submitted this 27th day of April, 1992.



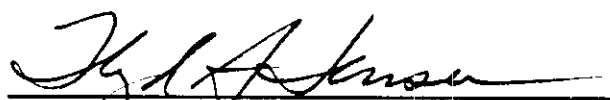
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ADDENDUM A

CONSTITUTIONAL PROVISIONS

AND

STATUTES

CONSTITUTION OF UTAH

ARTICLE I

DECLARATION OF RIGHTS

Sec. 7. [Due process of law.]

No person shall be deprived of life, liberty or property, without due process of law.

1896

ARTICLE V

DISTRIBUTION OF POWERS

Section

1. [Three departments of government.]

Section 1. [Three departments of government.]

The powers of the government of the State of Utah shall be divided into three distinct departments, the Legislative, the Executive, and the Judicial; and no person charged with the exercise of powers properly belonging to one of these departments, shall exercise any functions appertaining to either of the others, except in the cases herein expressly directed or permitted.

1896

ARTICLE VI

LEGISLATIVE DEPARTMENT

Section 1. [Power vested in Senate, House and People.]

The Legislative power of the State shall be vested:

1. In a Senate and House of Representatives which shall be designated the Legislature of the State of Utah.

2. In the people of the State of Utah, as hereinafter stated:

The legal voters or such fractional part thereof, of the State of Utah as may be provided by law, under such conditions and in such manner and within such time as may be provided by law, may initiate any desired legislation and cause the same to be submitted to a vote of the people for approval or rejection, or may require any law passed by the Legislature except those laws passed by a two-thirds vote of the members elected to each house of the Legislature to be submitted to the voters of the State before such law shall take effect.

The legal voters or such fractional part thereof as may be provided by law, of any legal subdivision of the State, under such conditions and in such manner and within such time as may be provided by law, may initiate any desired legislation and cause the same to be submitted to a vote of the people of said legal subdivision for approval or rejection, or may require any law or ordinance passed by the law making body of said legal subdivision to be submitted to the voters thereof before such law or ordinance shall take effect.

1900

ARTICLE VIII

JUDICIAL DEPARTMENT

Section 1. [Judicial powers — Courts.]

The judicial power of the state shall be vested in a supreme court, in a trial court of general jurisdiction known as the district court, and in such other courts as the Legislature by statute may establish. The Supreme Court, the district court, and such other courts designated by statute shall be courts of record. Courts not of record shall also be established by statute. 1984

ARTICLE XII

CORPORATIONS

Sec. 20. [Trusts and combinations prohibited.]

Any combination by individuals, corporations, or associations, having for its object or effect the controlling of the price of any products of the soil, or of any article of manufacture or commerce, or the cost of exchange or transportation, is prohibited, and hereby declared unlawful, and against public policy. The Legislature shall pass laws for the enforcement of this section by adequate penalties, and in case of incorporated companies, if necessary for that purpose, it may declare a forfeiture of their franchise. 1896

STATUTES

54-3-1. Charges must be just; service adequate; rules reasonable.

All charges made, demanded or received by any public utility, or by any two or more public utilities, for any product or commodity furnished or to be furnished, or for any service rendered or to be rendered, shall be just and reasonable. Every unjust or unreasonable charge made, demanded or received for such product or commodity or service is hereby prohibited and declared unlawful. Every public utility shall furnish, provide and maintain such service, instrumentalities, equipment and facilities as will promote the safety, health, comfort and convenience of its patrons, employees and the public, and as will be in all respects adequate, efficient, just and reasonable. All rules and regulations made by a public utility affecting or pertaining to its charges or service to the public shall be just and reasonable. The scope of definition "just and reasonable" may include, but shall not be limited to, the cost of providing service to each category of customer, economic impact of charges on each category of customer, and on the well-being of the state of Utah; methods of reducing wide periodic variations in demand of such products, commodities or services, and means of encouraging conservation of resources and energy.

1977

54-3-7. Charges not to vary from schedules — Refunds and rebates forbidden — Exceptions.

Except as in this chapter otherwise provided, no public utility shall charge, demand, collect or receive a greater or less or different compensation for any product or commodity furnished or to be furnished, or for any service rendered or to be rendered, than the rates, tolls, rentals and charges applicable to such products or commodity or service as specified in its schedules on file and in effect at the time; nor shall any such public utility refund or remit, directly or indirectly, in any manner or by any device, any portion of the rates, tolls, rentals and charges so specified; nor extend to any person any form of contract or agreement, or any rule or regulation, or any facility or privilege except such as are regularly and uniformly extended to all corporations and persons; provided, that the commission may, by rule or order, establish such exceptions from the operation of this prohibition as it may consider just and reasonable as to any public utility.

1953

54-4-1. General jurisdiction.

The commission is hereby vested with power and jurisdiction to supervise and regulate every public utility in this state, and to supervise all of the business of every such public utility in this state, and to do all things, whether herein specifically designated or in addition thereto, which are necessary or convenient in the exercise of such power and jurisdiction; provided, however, that the Department of Transportation shall have jurisdiction over those safety functions transferred to it by the Department of Transportation Act.

1975

54-4-4. Classification and fixing of rates after hearing.

(1) Whenever the commission shall find after a hearing that the rates, fares, tolls, rentals, charges or classifications, or any of them demanded, observed, charged or collected by any public utility for any service or product or commodity, or in connection therewith, including the rates or fares for excursion or commutation tickets, or that the rules, regulations, practices or contracts, or any of them, affecting such rates, fares, tolls, rentals, charges or classifications, or any of them, are unjust, unreasonable, discriminatory or preferential, or in anywise in violation of any provisions of law, or that such rates, fares, tolls, rentals, charges or classifications are insufficient, the commission shall determine the just, reasonable or sufficient rates, fares, tolls, rentals, charges, classifications, rules, regulations, practices or contracts to be thereafter observed and in force, and shall fix the same by order as hereinafter provided.

(2) The commission shall have power to investigate a single rate, fare, toll, rental, charge, classification, rule, regulation, contract or practice, or any number thereof, or the entire schedule or schedules of rates, fares, tolls, rentals, charges, classifications, rules, regulations, contracts and practices, or any number thereof, of any public utility, and to establish, after hearing, new rates, fares, tolls, rentals, charges, classifications, rules, regulations, contracts or practices, or schedule or schedules in lieu thereof.

(3) The commission, in its determination of just and reasonable rates, may consider recent changes in the utility's financial condition or changes reasonably expected, but not speculative, in the utility's revenues, expenses or investments and may adopt an appropriate future test period, not exceeding twelve months from the date of filing, including projections or projections together with a period of actual operations in determining the utility's test year for rate-making purposes.

1975

54-4-4.1. Rules to govern rates — Shared earnings.

(1) The commission may, by rule or order, adopt any method of rate regulation consistent with this title, including a method whereby revenues or earnings of a public utility above a specified level are equitably shared between the public utility and its customers.

(2) Not later than 60 days from the entry of an order or adoption of a rule adopting a method of rate regulation whereby revenues or earnings of a public utility above a specified level are equitably shared between the public utility and its customers, the public utility may elect not to proceed with the method of rate regulation by filing with the commission a notice that it does not intend to proceed with the method of rate regulation.

1990

54-7-12. Rate increase or decrease — Procedure — Effective dates — Electrical or telephone cooperative.

(1) As used in this section:

(a) "Rate increase" means any direct increase in a rate, fare, toll, rental, or other charge of a public utility or any modification of a classification, contract, practice, or rule that increases a rate, fare, toll, rental, or other charge of a public utility.

(b) "Rate decrease" means any direct decrease in a rate, fare, toll, rental, or other charge of a public utility or any modification of a classification, contract, practice, or rule that decreases a rate, fare, toll, rental, or other charge of a public utility.

(2) (a) Any public utility or other party that proposes to increase or decrease rates shall file appropriate schedules with the commission setting forth the proposed rate increase or decrease.

(b) The commission shall, after reasonable notice, hold a hearing to determine whether the proposed rate increase or decrease, or some other rate increase or decrease, is just and reasonable. If a rate decrease is proposed by a public utility, the commission may waive a hearing unless it seeks to suspend, alter, or modify the rate decrease.

(c) Except as otherwise provided in Subsections (3) and (4), no proposed rate increase or decrease is effective until after completion of the hearing and issuance of a final order by the commission concerning the proposed increase or decrease.

(3) The following rules apply to the implementation of any proposed rate increase or decrease filed by a utility or proposed by any other party and to the implementation of any other increase or decrease in lieu of that proposed by a utility or other party that is determined to be just and reasonable by the commission:

(a) On its own initiative or in response to an application by a public utility or other party, the commission, after a hearing, may allow any proposed rate increase or decrease, or a reasonable part of the rate increase or decrease, to take effect, subject to the commission's right to order a refund or surcharge, upon the filing of the utility's schedules or at any time during the pendency of its hearing proceedings. The evidence presented in the hearing held pursuant to this subsection need not encompass all issues that may be considered in a rate case hearing held pursuant to Subsection (2)(b), but shall establish an adequate prima facie showing that the interim rate increase or decrease is justified.

(b) (i) If the commission completes a hearing concerning a utility's revenue requirement before the expiration of 240 days from the date the rate increase or decrease proposal is filed, it may issue a final order within that period establishing the utility's revenue requirement and fixing its interim allowable rates before it determines the allocation of the increase or decrease among categories of customers and classes of service.

(ii) If the commission in its final order on a utility's revenue requirement finds that the interim increase order under Subsection

(3)(a) exceeds the increase finally ordered, it shall order the utility to refund the excess to customers. If the commission in its final order on a utility's revenue requirement finds that the interim decrease order under Subsection (3)(a) exceeds the decrease finally ordered, it shall order a surcharge to customers to recover the excess decrease.

(c) If the commission fails to enter its order granting or revising a revenue increase within 240 days after the utility's schedules are filed, the rate increase proposed by the utility is final and the commission may not order a refund of any amount already collected by the utility under its filed rate increase.

(d) (i) When a public utility files a proposed rate increase based upon an increased cost to the utility for fuel or energy purchased or obtained from independent contractors, other independent suppliers, or any supplier whose prices are regulated by a governmental agency, the commission shall issue a tentative order with respect to the proposed increase within ten days after the proposal is filed, unless it issues a final order with respect to the rate increase within 20 days after the proposal is filed.

(ii) The commission shall hold a public hearing within 30 days after it issues the tentative order to determine if the proposed rate increase is just and reasonable.

(4) (a) Notwithstanding any other provisions of this title, any schedule, classification, practice, or rule filed by a public utility with the commission that does not result in any rate increase shall take effect 30 days after the date of filing or within any lesser time the commission may grant, subject to its authority after a hearing to suspend, alter, or modify that schedule, classification, practice, or rule.

(b) When the commission suspends a schedule, classification, practice, or rule, it shall hold a hearing on the schedule, classification, practice, or rule before issuing its final order.

(c) For purposes of this Subsection (4), any schedule, classification, practice, or rule that introduces a service or product not previously offered may not result in a rate increase.

(5) (a) Notwithstanding any other provision of this title, whenever a common carrier files with the commission any schedule, classification, practice, or rule that does not result in an increase in any rate, fare, toll, rental, or charge, the schedule, classification, practice, or rule shall take effect 30 days after the date of filing or at any earlier time the commission may grant, subject to the authority of the commission, after a hearing, to suspend, alter, or modify the schedule, classification, practice, or rule.

(b) (i) Notwithstanding any other provision of this title, whenever a common carrier files with the commission a request for an increase in rates, fares, tolls, rentals, or charges based solely upon cost increases to the common carrier of fuel supplied by an independent contractor or independent source of supply, the requested increase shall take effect ten days after the filing of the request with the commission or at any earlier time after the filing of the request as the commission may by order permit.

(ii) The commission shall order the increase to take effect only after a showing has been made by the common carrier to the commission that the increase is justified.

(iii) The commission may, after a hearing, suspend, alter, or modify the increase.

(6) This section does not apply to any rate changes of an electrical or telephone cooperative that meets all of the following requirements:

(a) The cooperative is organized for the purpose of either distributing electricity or providing telecommunication services to its members and the public at cost. "At cost" includes interest costs and a reasonable rate of return as determined by the cooperative's board of directors.

(b) The cooperative's board of directors and any appropriate agency of the federal government have approved the rate increase or other rate change and all necessary tariff revisions reflecting the increased rate or rate change.

(c) Before implementing any rate increases, the cooperative has held a public meeting for all its customers and members. The cooperative shall mail a notice of the meeting to all of the cooperative's customers and members not less than ten days prior to the date that the meeting is held.

(d) The cooperative has filed its tariff revisions reflecting the rate increase or other rate change with the commission, who shall make the tariffs available for public inspection.

(7) Procedures for the implementation of a proposed rate increase by a telephone corporation having less than 5,000 subscriber access lines are as follows:

(a) (i) The proposed rate increase may become effective upon the filing of the proposed tariff revisions and necessary information to support a determination by the commission that the proposed rate increase is just and reasonable.

(ii) The telephone corporation shall provide 30 days' notice to the commission and all potentially affected access line subscribers of the proposed rate increase.

(b) (i) The commission may investigate whether the proposed rate increase is just and reasonable.

(ii) If the commission determines, after notice and hearing, that the rate increase is unjust or unreasonable in whole or in part, the commission may establish the rates, charges, or classifications that it finds to be just and reasonable.

(c) The commission shall investigate and hold a hearing to determine whether any proposed rate increase is just and reasonable if 10% or more of the telephone corporation's potentially affected access line subscribers file a request for agency action requesting an investigation and hearing.

1989

63-46b-10. Procedures for formal adjudicative proceedings — Orders.

In formal adjudicative proceedings:

(1) Within a reasonable time after the hearing, or after the filing of any post-hearing papers permitted by the presiding officer, or within the time required by any applicable statute or rule of the agency, the presiding officer shall sign and issue an order that includes:

(a) a statement of the presiding officer's findings of fact based exclusively on the evidence of record in the adjudicative proceedings or on facts officially noted;

(b) a statement of the presiding officer's conclusions of law;

(c) a statement of the reasons for the presiding officer's decision;

(d) a statement of any relief ordered by the agency;

(e) a notice of the right to apply for reconsideration;

(f) a notice of any right to administrative or judicial review of the order available to aggrieved parties; and

(g) the time limits applicable to any reconsideration or review.

(2) The presiding officer may use his experience, technical competence, and specialized knowledge to evaluate the evidence.

(3) No finding of fact that was contested may be based solely on hearsay evidence unless that evidence is admissible under the Utah Rules of Evidence.

(4) This section does not preclude the presiding officer from issuing interim orders to:

(a) notify the parties of further hearings;

(b) notify the parties of provisional rulings on a portion of the issues presented; or

(c) otherwise provide for the fair and efficient conduct of the adjudicative proceeding.

1988

63-46b-16. Judicial review — Formal adjudicative proceedings.

(4) The appellate court shall grant relief only if, on the basis of the agency's record, it determines that a person seeking judicial review has been substantially prejudiced by any of the following:

(a) the agency action, or the statute or rule on which the agency action is based, is unconstitutional on its face or as applied;

(b) the agency has acted beyond the jurisdiction conferred by any statute;

(c) the agency has not decided all of the issues requiring resolution;

(d) the agency has erroneously interpreted or applied the law;

(e) the agency has engaged in an unlawful procedure or decision-making process, or has failed to follow prescribed procedure;

(f) the persons taking the agency action were illegally constituted as a decision-making body or were subject to disqualification;

(g) the agency action is based upon a determination of fact, made or implied by the agency, that is not supported by substantial evidence when viewed in light of the whole record before the court;

(h) the agency action is:

(i) an abuse of the discretion delegated to the agency by statute;

(ii) contrary to a rule of the agency;

(iii) contrary to the agency's prior practice, unless the agency justifies the inconsistency by giving facts and reasons that demonstrate a fair and rational basis for the inconsistency; or

(iv) otherwise arbitrary or capricious. 1988

ADDENDUM B

**THE PUBLIC SERVICE COMMISSION
OF UTAH**

REPORT AND ORDER

DATED JUNE 19, 1990

DOCKETED

- BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH -

In the Matter of the Application)	<u>DOCKET NO. 90-049-03</u>
of US WEST COMMUNICATIONS for)	
Approval of an Incentive Regulation)	
Plan.)	
)	<u>REPORT AND ORDER</u>
In the Matter of the Investigation)	
into the Reasonableness of the)	
Rates and Charges of US WEST)	<u>DOCKET NO. 90-049-06</u>
COMMUNICATIONS.)	

ISSUED: June 19, 1991

SHORT TITLE

1990 General Rate Case

SYNOPSIS

The Commission herein orders a reduction in revenue requirement of \$19,799,000. The reduction is based on a stipulation by the parties on all issues except depreciation expense and cost of capital, which is set by the Commission at 12.2 percent rate of return on common equity and 10.93 percent rate of return on investment. Revenue requirement reductions ordered in this docket, the sum of two interim reductions and this final one, total \$38,748,000. In addition, the Commission adopts a proposal to invest in central office and transport plant and equipment to modernize and upgrade the network. The Commission also formulates an "incentive regulation" plan which, if implemented, would permit the Company to retain a share of excess earnings, if any, over the allowed rate of return, as an incentive to promote more efficient utility operations.

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John W. Horsley	"	Contel of the West
James L. Barker, Jr.	"	Justin Stewart, et. al.
James J. Cassity	"	Union Telephone Company

I. PROCEDURAL HISTORY

On March 2, 1990, US WEST Communications (USWC or the Company) filed an application with the Commission seeking approval of an incentive regulation plan. Docket No. 90-049-03 was assigned to the case. As part of the application, USWC provided a general description of its proposed plan, which contained both incentive regulation and network modernization proposals. On March 16, 1990, the Committee of Consumer Services (Committee) filed a Motion to Dismiss Application and Strike Docket on the ground that Senate Bill 115, the legislation that enacted Utah Code Ann. Section 54-4-4.1 (1991), had not yet become law. On March 26, 1990, USWC filed its detailed Utah Incentive Regulation Plan.

On March 28, 1990, the Division of Public Utilities (Division) filed a Petition in Docket No. 90-049-06 seeking an investigation into the reasonableness of the rates and charges of USWC and requesting a hearing to consider an interim rate reduction of \$5.7 million.

On April 27, 1990, the Committee withdrew its Motion to Dismiss when USWC agreed that its application be deemed to have been refiled on April 27, 1990. In its Order of May 10, 1990, the Commission ruled that USWC's application and other pleadings relating to incentive regulation would be deemed to have been refiled as of April 27, 1990 without the necessity of actually refiling them. In the same order, the Commission ordered that Docket Nos. 90-049-03 and 90-049-06 be "consolidated for purposes of hearing only," and

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established a schedule for filing of testimony and for hearings. The Commission required that analyses of both the incentive and the modernization plans consider the current definition of "universal service" as well as what would be required when the term of a plan ended. In late April 1990, the Division and the Committee filed testimony in support of their requests for an interim decrease. On May 1, 1990, the Committee filed a motion requesting that the Commission reduce rates on an interim basis by \$16 million. On May 18, 1990, USWC filed responsive testimony regarding the proposed interim rate decrease. The Division filed supplemental testimony on May 18 and May 23, 1990, increasing its requested interim decrease to \$8.6 million. Hearings were held on May 24-25, 1990. Following the hearings, various parties filed briefs summarizing their positions regarding the proposed interim rate decrease. On June 22, 1990, the Commission ordered an interim rate decrease of \$10.65 million, based on a 1989 test year, 11.8 percent return on equity, and adjustments consistent with those ordered in Docket No. 88-049-07. The Commission also determined that the standards for interim rate decreases and increases need not be the same.

On June 29, 1990, USWC filed its direct testimony on incentive regulation issues, as well as amendments to its proposed Utah Incentive Regulation Plan. On July 12, 1990, the Commission issued its order amending the schedule. On July 20, 1990, parties (other than USWC) filed position statements on incentive regulation issues. On August 14, 1990, the Commission issued its Second Amended Scheduling Order revising some of the filing and hearing dates. On

August 27, 1990, various parties filed their preliminary revenue requirement calculations. On September 8-9, 1990, the Second Amended Scheduling Order was published in the Salt Lake Tribune and the Deseret News. In early October 1990, various parties filed testimony on rate of return and capital structure issues.

On October 24, 1990, all parties filed testimony in response to USWC's proposed incentive regulation plan. On October 30, 1990, USWC, the Division, the Committee, and AT&T entered a Stipulation and Joint Motion on Revenue Requirement Issues, resolving most revenue requirement issues, and calling for a further interim reduction of \$8.238 million to be implemented January 1, 1991. On October 31, 1990, James L. Barker, representing himself and six other intervenors, filed a Request for Declaratory Order challenging the constitutionality of 54-4-4.1, the statute that enables the Commission to adopt earnings sharing plans like the one proposed by USWC. On November 1, 1990, the Commission issued its Third Amended Scheduling Order. On November 23, 1990, the Commission issued its Fourth Amended Scheduling Order in which it ordered parties to consider the effects of demand for service on depreciation, and stated that the determination of revenue requirement must address the persistence of overearnings. In addition, the Commission ordered that the interim rate reduction be spread on an equal percentage basis to residence and business local exchange services, toll, and switched access, excluding nonrecurring charges, and stated the Commission's determination of its authority to order investments to upgrade the system. On November 26, 1990, the parties filed rebuttal

testimony on rate of return and capital structure issues. On December 4, 1990, pursuant to the request of the Company, the Commission issued a Revised Public Notice of Hearing, which was published in the Salt Lake Tribune and the Deseret News on December 8-19, 1990, and which was mailed directly to all persons and entities who had filed letters with the Commission indicating an interest in incentive regulation and network modernization issues. On December 8, 1990, the parties filed surrebuttal testimony on rate of return and capital structure issues. On December 17-19, 1990, the Commission held hearings on the Stipulation and Joint Motion on Revenue Requirement and on rate of return and capital structure issues. By order issued January 3, 1991, the Commission approved the Stipulation pursuant to its terms. On January 11, 1991, the parties filed briefs on rate of return and capital structure issues. On January 16, 1991, all parties filed rebuttal testimony on incentive regulation issues. On January 18, 1991, the parties filed testimony on depreciation represcription issues. Also on January 18, 1991, several parties filed briefs and motions responding to Mr. Barker's Request for Declaratory Order. On January 22, 1991, the parties filed direct testimony on rate design issues. In late January and early February 1991, various witnesses filed additional testimony on depreciation represcription issues. The Commission held a hearing on February 8, 1991 on depreciation represcription. Also on February 8, 1991, Mr. Barker filed a Reply Memorandum regarding the constitutional issues. On February 15, 1991, the parties filed surrebuttal testimony on incentive regulation issues and rebuttal

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testimony on rate design issues. On February 22, 1991, the Commission issued an order dismissing Mr. Barker's Request for Declaratory Order. Hearings on incentive regulation and rate design issues commenced on February 28, 1991 and concluded on March 13, 1991.

On April 19, 1991, USWC, the Division and the Committee filed position statements regarding disputed issues relating to the Stipulation and Joint Motion on Revenue Requirement Issues. On April 26, 1991, the same parties filed responsive position statements. On May 1, 1991, USWC moved that the Commission accept the position statements as evidence in this proceeding and sought oral argument. On May 15, 1991, USWC, the Division and the Committee presented oral argument on the disputed issues relating to the Stipulation and the position statements were accepted as evidence in this proceeding.

II. DISCUSSION, FINDINGS, AND CONCLUSIONS
WITH RESPECT TO REVENUE REQUIREMENT

A. STIPULATION

On October 30, 1990, the parties entered into a Stipulation that was intended to resolve all revenue requirement issues except depreciation and cost of capital, which were reserved for later hearing. Following hearings on December 17th, the Commission adopted the Stipulation by order issued January 3, 1991.

The October Stipulation was based on the first six months of 1990 actual results of intrastate operations then available and the Company's budget estimates for the calendar year 1990.

Attached to the Stipulation was a Joint Exhibit in which 32 adjustments to actual results were identified. The value of 23 of the adjustments were to be held fixed, including the June 22, 1990 interim rate reduction, and the value of the remaining nine adjustments were to be updated when actuals for all 12 months of 1990 became known. The intent of the signatory parties to rely on the Stipulation as crafted and to exclude consideration of further adjustments is made clear in paragraphs six and seven of the Stipulation.

The Stipulation is a negotiated settlement of revenue requirement issues, as distinct from each party advancing its own interest through discovery and hearing, in an adversarial way, on every single issue. Negotiation is a process of compromise in the interest of reaching an end result that each party is able to accept. The Commission has criticized this process of bargaining and compromise before, because it leaves the Commission unaware of important details. The Commission knows only outcomes. In addition, and perhaps most importantly, some issues have been "decided" in the course of the negotiations without having been brought to the Commission's attention. Therefore, the Commission has been reluctant to accept stipulations in recent major cases, and, where stipulation seemed the prudent course, has sought to confine them to purely technical as distinct from policy issues.

In the current docket, stipulation was entertained as the reasonable course in order to free up Company and regulatory resources to deal with the Company's incentive and modernization

proposals. Also, it seemed revenue requirement issues, according to the parties, could be resolved in conformance with Commission decisions rendered in the previous, recently concluded Docket No. 88-049-07. Since the issues were not to be reargued, the policy aspect was removed, and resolution would be on technical grounds.

It is in this context that, later in the docket proceedings, parties began to argue the meaning of the Stipulation's limitation on updates and adjustments of test year data. USWC proposed four new adjustments to test year data, on issues the other signatory parties had not seen at the time the Stipulation was signed and which had the effect of increasing revenue requirement. The Division then sought to update several of the 23 adjustments which the Stipulation said could not be updated and which had the effect of decreasing revenue requirement. The Committee argued that the plain meaning of the Stipulation prevented either the introduction of new adjustments or the updating of fixed adjustments, and urged the Commission to reject them both.

The Commission could not have been presented a more penetrating example of the problematic nature of stipulations. Here, signatory parties could not agree what their own words meant, and seized this dispute as an opportunity to advance their own interests on what otherwise might have been reasonable grounds. USWC argued its proposed new adjustments were of the sort routinely permitted in the normal fashioning of a test year. With the full 12 months of 1990 actual results of operations information in hand, the Division

argued the superiority of these "actuals" to the budget information upon which the Stipulation was based.

When the Commission accepted the Stipulation on January 3, 1991, the nature of the document as a compromise based on the best information then available to the parties was clearly understood. That each party must have given up something in signing the Stipulation, and might on some issues have argued differently if given the chance in an adversarial proceeding, goes without saying; that is the very purpose of negotiation in a settlement conference. It is what is meant by stipulation. Parties cannot now come back to the Commission and attempt to redefine things to their own advantage. To do so places the Commission at an unacceptable disadvantage and severely compromises case proceedings. The record does not contain full examination of contested issues. The Division has not audited the 1990 information and neither the Division nor the Committee can state what, except for the agreement reached in the Stipulation itself, the test year would ideally be.

There has also been some discussion about what the parties could, did, or should have understood was contemplated by the Stipulation. At this point in time, all that is important is what the Commission understood to be stipulated to by the parties at the time it accepted the Stipulation. None of the adjustments now argued for by USWC or the Division were considered open issues by the Commission. On this basis, the Commission has two choices. The Stipulation can be accepted without alteration except as specifically permitted by its terms, or the case record can be reopened for

receipt of further information intended to redefine the test year. Reopening the record is not acceptable. To do so would be tantamount to beginning the revenue requirement determination anew. There is no doubt that each moment's delay in reducing rates costs ratepayers money. This the Commission cannot countenance. Therefore, the Commission concludes the Stipulation must be accepted essentially unaltered. Parties are, as always, free to bring a new action to further examine rates as soon as this order is final.

The Commission finds that the new adjustments proposed by the Company are not permitted by the terms of the Stipulation and are therefore rejected. The Commission finds that the updates proposed by the Division are not permitted by the terms of the Stipulation and are likewise rejected.

There exists one remaining dispute regarding the interpretation of the Stipulation, that being the treatment of the June interim rate reduction. On June 22, 1990, the Commission ordered that rates be reduced to achieve a revenue reduction of \$10,655,000 pending a final order establishing permanent rates in this proceeding. As implemented the interim reduction totalled \$10,711,000 effective June 22, 1990, for local exchange service, July 1, 1990, for 800 and OutWATS services, and July 18, 1990, for message toll and switched access services. In the Stipulation the parties have agreed to properly annualize and normalize 1990 actual revenues to reflect the realized \$10,711,000 revenue decrease on a prospective annual basis.

What is in dispute is the method by which the interim reduction is to be annualized. The Company interpreted the Stipulation to mean that the total \$10.7 million be removed from actual 1990 revenues as if the reduction had been in place for the entire year as shown in the Joint Exhibit attached to the Stipulation. The Division and the Committee interpreted the Stipulation to mean that the method of annualization should reflect the mid-year timing of the reduction and that the \$10.7 million shown in the Joint Exhibit was to illustrate the parties' agreement to the total reduction to be considered as the basis for annualization. In order to fully reflect the realized \$10,711,000 revenue reduction on a prospective, annualized basis as agreed to by the parties, the Commission finds that actual 1990 revenues need to be reduced by \$5,080,000 to account for the mid-year timing of the interim reduction and thereby remove the impact of the higher rates in effect only during the first half of 1990.

B. DEPRECIATION

On November 23, 1990, USWC submitted its triennial depreciation study to both the Federal Communications Commission (FCC) and this Commission. This study proposed changes in the projection-lives and future-net-salvage parameters previously approved by the Commission in 1988. In conjunction with the rate case and the Incentive Regulation Plan, the Commission requested that the Division review the study and report to the Commission with recommendations. Following its review of the study, the Division

conducted an audit and held discussions with USWC's corporate staff in Denver.

On January 18, 1991, USWC filed direct testimony and on February 5, 1990, rebuttal testimony detailing the depreciation rates for the three-year period January 1, 1991 through December 31, 1993. This study involved a detailed examination of historical data coupled with expert evaluation of the plans, trends, developments and other factors that impact on the future life expectancy of existing plant and equipment.

The Company, through witness Jerry D. Harris, testified that the depreciation study was prepared in conformance with extensive depreciation study guidelines established by the FCC. The study process required an extensive analysis of each depreciable plant account to determine the appropriate projection life, future net salvage and retirement curve shape which constituted depreciation rate parameters.

The Company proposed to increase its annual Utah intrastate depreciation expense by \$7,891,000.

The Division submitted its analysis of the depreciation study to the Commission through testimony filed by Division witness Larry Fuller. The Division recommended two alternative equipment life and depreciation expense proposals. The first alternative was based on "business as usual" absent the modernization proposal and would decrease intrastate depreciation expense by \$9,337,000 annually. The second alternative included changes that would be justified if the Commission approved the modernization plan with or

without an Incentive Regulation Plan. This alternative would result in a decrease in intrastate depreciation expense of \$4,441,000 annually.

The Committee filed testimony by Michael Arndt providing comments concerning USWC's 1991 Utah depreciation rate study and recommended a decrease in the annual intrastate depreciation expense of \$7,151,000 annually.

The Commission heard testimony on February 6, 1991 concerning the differences in equipment service lives and depreciation philosophies recommended by the different parties.

USWC stated that the purpose of depreciation is to recover the capital investment of the Company over the useful life of the investment and that such recovery is accomplished by the proper estimation of expected lives of the assets.

The Division stated that the first objective of the depreciation review is to establish depreciation rates based on Utah-specific evaluations of the projected service lives of the various existing equipment investment accounts. A secondary objective is to establish overall annual depreciation expenses that would help synchronize investment requirements for future equipment that will be replacing the existing equipment.

The Committee proposed that the depreciation rates the Commission approves be applied to the Company's average 1990 plant investment. Use of the 1990 average depreciable plant investment would produce the necessary matching of revenues, expenses and investment for the 1990 test year.

Considerable testimony on depreciation represcription was directed towards the correct interpretation of depreciation accounting. The Committee asserted that depreciation expense constitutes customer contributed capital. The Company argued and presented evidence that depreciation expense is an accounting mechanism to recover investors' funds for capital expenditures. The Commission agrees with the Company's definition of depreciation accounting. However, this Commission determines depreciation policy. In past decisions, the Commission has granted shorter asset lives and thereby increased depreciation expense. One result of this policy has been to protect the Company from the risks of technological obsolescence. Another has been to enhance the Company's positive cash flow thus enabling it to continue to expand and modernize the Utah infrastructure. The Commission finds that there is an implied relationship between its depreciation policy and its expectations for prudent and economic future investments.

The Commission finds that the Division's proposed depreciation parameters and associated depreciation rates consistent with the proposed Modernization Plan should be applied for the purpose of determining test year revenue requirement. Booking of the new depreciation expenses shall be ordered retroactively to January 1, 1991. In the future, the Commission will require the use of average plant balances for the purpose of computing depreciation expense.

C. COST OF CAPITAL1. COST OF EQUITY CAPITAL

Witnesses for USWC, the Division, and the Committee presented equity cost of capital testimony in this docket. Testifying for USWC, Peter C. Cummings placed equity cost at 14.5 - 15.0 percent, and argued that a finding in favor of the incentive form of regulation necessitated the addition of 50 basis points or an equity return award at the high end of the range. A second company witness, Dr. Roger A. Morin, generally supported Mr. Cummings' position, but in final testimony estimated equity cost as 13.5 - 14.0 percent. Dr. George Compton, witness for the Division, gave a range of 11.1 - 11.6 percent as that within which the cost of equity might, depending upon the assumptions chosen, reasonably be found. The Committee's witness, Dr. Matityahu Marcus, related his estimate of equity cost directly to the capital structure used in the proceeding: 11.3 percent, if USWC's; 11.8 percent, if USW Inc.'s.

Witness Cummings developed his equity cost estimate by analyzing three groups of companies, which he selected to be comparable to USWC, using the Discounted Cash Flow (DCF) and the Capital Asset Pricing Model (CAPM) models. He argued in favor of the CAPM approach, and checked his results for reasonableness by comparing them with returns associated with the S & P 500 (slightly higher, as would be expected given a utility's lower risk), and with USW Inc.'s cost of new debt. Since the latter is approximately 10 percent, an equity return four to five percentage points higher is reasonable, he asserted. Moreover, issuance costs should be included

in the equity return award. Though he agreed that capital costs in general have declined since the last equity award, and even since direct testimony was filed in this docket, the witness argued that other relevant factors supported his higher estimate. His claim that incentive regulation, if adopted, would necessitate the addition of 50 basis points, owed to his conclusion that increased risk would be incurred by USWC (the result of the changed nature of regulation and the agreement by the Company not to seek rate increases). According to the witness, sole reliance should not be placed on the results of a DCF analysis because at the current time the technique uniformly gives results that are too low. One possible reason, he asserted, is the failure of current market price of common equity stock to adequately reflect the future value of USW Inc's cellular business. A key point in the witness's analysis is the use of nonregulated firms in samples of alleged comparability. This, he asserted, is a legal requirement arising under the Hope and Bluefield decisions of the U.S. Supreme Court. He did not dispute, however, that the return awarded in the last docket, 11.8 percent, had been sufficient to permit, as legally required under these decisions, the Company to raise capital at reasonable rates. The witness did acknowledge that the Company is close to 100 percent internally financed, owing largely to depreciation and deferred tax sources. He also acknowledged that USWC has lower risk than its parent, USW Inc.

The second rate of return witness for the Company, Dr. Morin, asserted that several methods, and not simply the DCF, must be used to estimate equity cost. Thus, he applied risk premium, CAPM,

and DCF methods to sample companies. A particular point he made was the difficulty of estimating the dividend growth rate, the variable 'g' in the DCF formula at moments, such as the present, of unusual economic conditions. According to the witness, the DCF may under- or over-estimate the cost of capital when interest rates are moving strongly; hence, its results should be evaluated in the context of other models' results. When the results from several models cluster closely around a particular value, a good indication of equity cost is obtained; but when, as in this case, the results of DCF applications are at variance, he asserted, the analyst should question whether the model's assumptions adequately reflect current conditions. They do not, he contended. Emerging competition and a tendency toward deregulation are putting telecommunication utilities in a different risk category than electric and natural gas utilities, he stated, making them more like industrials generally. He agreed with Mr. Cummings that USWC is a less risky entity than its parent, USW Inc., however. Sample firms to be used to estimate equity cost for the utility must be selected on the basis of comparable risk, and for this purpose no single measure of risk is alone sufficient, according to the witness. Selection of sample firms is therefore a difficult analytical task, but this is no reason simply to rely on telecommunication companies--the seven regional holding companies--alone, he said. Doing so is defective analysis owing to inherent circularity of reasoning involved, according to Dr. Morin. Because of this and his assertion that utilities are now more like industrials as to characteristics of risk, Dr. Morin based his equity

cost estimate on a sample composed equally of regional holding companies and industrials.

Dr. Compton, witness for the Division, stressed the point that all evidence showed a decline in capital costs since the last rate case. Based on his analysis, a return on equity award in this docket should not be higher than the 11.8 percent currently allowed, the range of reasonable estimates now being 11.1 - 11.6 percent. His explanation for why this is 300 and more basis points below Company witnesses' recommendations lies generally in the degree of emphasis placed upon the DCF model and the analysis of risk supporting choice of comparable firms. Dr. Compton stated that comparability of risk is indicated by similarity of results obtained from DCF analysis, and questioned the wisdom of relying on the risk measure 'beta' as company witnesses had done. He indicated the role played by beta in portfolio analysis, distinguishing this from the task of selecting comparable firms for rate of return estimation. The witness supported inclusion of flotation costs in theory and, as to the appropriate version of the DCF model to use, supported one that incorporates the quarterly dividend adjustment. He did not, however, alter his final recommendation to account for either of these because, in his opinion, they were offset by other factors.

Testifying for the Committee, Dr. Marcus directly related his equity cost recommendation to capital structure, arguing that USWC is less risky than its parent, USW Inc., as is its capital structure. Thus, if USWC's capital structure is employed, the proper equity return is 11.3 percent, he stated, whereas, if the capital

structure is to be the parent's, equity return should be 11.8. His recommendation is that USWC's capital structure and equity return are what is at issue in this proceeding and, since both can be estimated adequately, they are what should be considered. Hence, the appropriate equity award is 11.3 percent. Dr. Marcus employed the DCF model and argued this is appropriate for a company like USW, which is one of the 50 largest in the U.S., is a stable entity because the bulk of its revenues is from telecommunications operations, and is continuously analyzed by at least a dozen security analysts. It is the sort of company for which there are no directly comparable firms, he stated. In fact, owing to the points enumerated, direct observation is appropriate; there is no compelling need to seek proxies, he testified. Comparable companies cannot be selected on the basis of a single risk measure like beta, as Company witnesses had done, in any event, according to Dr. Marcus. Other risk measures, including those employed by Dr. Morin, give different results, thus requiring the exercise of judgment by the witness. He argued beta is unreliable if used to select comparable firms. In particular, the beta indication that telecommunications utilities are riskier than natural gas and electric utilities, as asserted by Dr. Morin on the basis largely of his beta analysis, cannot stand, said Dr. Marcus. He asserted, moreover, that the difference between regulated utilities and unregulated industrials is a critical one that cannot be ignored in the selection of comparable firms. Dr. Marcus did not support inclusion of issuance costs in an equity return award for this company because the Company issues stock at

prices well above book value, benefitting existing shareholders by an amount greater than such costs might be. Regulators set return based on book value, he stated, and book value had gone up. Moreover, the facts alone do not justify allowance for issuance costs, according to the witness, if only because such costs apply to the sale of common equity in the market. The Company, by contrast, can finance internally, and, as a supporting point, no evidence shows such costs were transferred to USWC at divestiture. Nothing at this time suggests the DCF model cannot be relied upon, he averred, and arguments to the contrary are misleading if based on the notion that things are in flux, for in fact, things are always in flux. There is also evidence for the proposition that the DCF may now be overvaluing equity cost, given Company witnesses' testimony that the market may be undervaluing stock price. This is at least as credible as these witnesses' assertion that the DCF-determined equity cost is too low, according to Dr. Marcus.

The Commission believes it necessary to estimate the costs of equity of USWC, the regulated utility, not USW Inc., the parent corporation, though analysts may focus on USW Inc. as the entity which issues common stock. All witnesses agree that USWC is not as risky as USW Inc., and this fact, considered alone, argues for an equity award lower than would be indicated by an analysis of USW. Dr. Marcus, for example, quantifies this risk difference at 50 basis points.

When the DCF analysis is performed consistently and in line with our discussions and decisions in recent orders, it becomes

difficult to argue for an equity award much above the existing 11.8 percent arises. There is no ambiguity about the fact that, throughout the economy, since the last USWC rate case, capital costs have trended downward. This trend has meant that all witnesses reduced their recommendations between the filing of direct testimony and the close of the hearing, a short time later. Nor does this case, in spite of the efforts of Company witnesses, produce new evidence or persuasive argument to convince us to revise our negative views of the capital asset pricing model and risk premium approaches to estimation of equity cost. Moreover, the Company's argument that reliance on a DCF analysis to estimate the cost of equity must produce, under current circumstances in the industry and economy, an unreasonable result, fails on this record. This is the case principally because their analysis of comparable companies was not convincing. The determination of risk similarity, which is the heart of the approach, was not adequate.

Were this a complete summary of our conclusions, a return award at, or, more probably, below the current allowed return would be inescapable. But the fact is, near term conditions in the industry and the economy are quite unsettled. We have on this record, for example, expert witness opinions that are diametrically opposed. Company witnesses have argued that the DCF underestimates equity cost because the model cannot be relied upon during times of strong interest rate movement and because the market has not yet properly valued the future potential of a present Company position in cellular. The Committee witness, on the other hand, testified that

the DCF might be producing a cost of equity estimate that is too high, if the opinion of Company executives that the market currently undervalues USW's common stock is reliable.

Expert witness disagreement is not unusual. But where performance of common stock in the market is so critical to the analysis, the lack of agreement as to future direction--not magnitude--of change is notable. This difference of opinion seems rooted in appraisals of general conditions in the economy; that is, where things now stand in relation to the business cycle, and how the market price of USW Inc.'s common stock can be expected to move with respect to it. These appraisals are decidedly different. The Commission is aware that utility stock price movements bear a relationship to interest rate changes. Should interest rates go up in the near future, as may be the case if the attention of policy makers shifts from recession to inflation, the market price of utility common stock, other things being equal, would tend to fall and the cost of equity to rise.

Too much should not be made of such speculation, not least because no coherent form of it appears on the record--though it is generally acknowledged that utility common stock prices and interest rates vary inversely. The testimony of Company witnesses stands for the proposition that this relationship is weakening as telecommunications firms begin to look more like industrials. But their point is disputed. It does, however, focus attention, and quite properly, on uncertainty, the basic problem a cost of capital witness must confront. Any model employed has its principal value in

providing a structure by which uncertainty can be managed. This value derives mainly from a consensus among experts that the model is useful and produces results that can be relied upon. For example, in the DCF, the growth component, 'g', cannot be known with certainty, but the model gives an acceptable way of estimating it. The DCF permits an evaluation of market price on the basis of the future flow of dividends and the investors' required rate of return (estimated, of course); the problem of estimating 'g' is to infer what growth rate in dividends is currently being expected by investors. But by one technique of analysis or another, each model permits its user to grapple with the uncertainty of the future, and to do so in ways that have been found acceptable.

The Commission's task is to estimate the investors' required rate of return. The models used by witnesses present a range of estimates of the cost of equity capital. Required rate of return and cost of equity capital may differ for several reasons, including the allowance of flotation costs, adjustments for management performance, and other factors. In this docket, the Commission finds the required return exceeds the cost of capital estimate produced by mechanical application of the DCF model.

Estimating investors' required return is an exercise of informed judgment. At its heart, the problem is placed in an uncertain future, where many things, both known and unknown, affect outcomes. The problem is complex and subtle. Mathematical models are a guide and a framework for thinking about the problem, but are no substitute for the exercise of informed judgment. Unqualified

reliance on model results would be misplaced. For example, it is easily shown on the record in this docket that the DCF may, under present circumstances, both over- and underestimate equity cost. Even so, the Commission regards it as more reliable than the CAPM and risk premium approaches, but acknowledges the effort of Company witnesses to discredit the DCF and to elevate CAPM and risk premium.

The key to the return on equity decision is an award which adequately compensates investors for willingness to bear risk. Our knowledge of the determinants of, measurement of, and implications of risk assessment, is, on this record, incomplete. Part of the reason is to be found in the nature of the problem, as discussed previously, and part in the failure of the record to contain a complete and coherent examination. The record, instead, contains expert testimony on various aspects of risk in relation to return, but only disputes on how well it has been measured. This is particularly evident in the comparable firms entanglement. A sample of firms selected on the basis of one risk measure, such as beta, is unreasonable, and the more so where other allegedly supplemental measures the analyst may have employed seem to confound choice rather than to clarify it. The Commission finds that no single measure of risk can be sufficient to establish the risk comparability of firms.

The U.S. Supreme Court decisions, Hope and Bluefield, cited by witnesses cannot reasonably be read to require comparison of a regulated utility with non-regulated firms. These entities are so unlike one another that, whatever the merit of attempting to escape circular reasoning, the difficulties in establishing risk

comparability have not been overcome on this record. The Commission finds that this task has not been accomplished, and, were it a straightforward requirement of the Court, as Company witnesses seem to assert, no decision could be made unless the record were supplemented. This, the Commission rejects. On one point, however, the record is clear. Attraction of capital under reasonable terms is a test articulated by these Court decisions. A return on equity decision must be compatible with it. Evidence is uncontroverted that the Company has been able to attract capital favorably with the 11.8 percent return on equity awarded in the previous docket.

Through testimony, USWC has attempted to liken itself to an unregulated company, loosely fitting the market's 'industrials' category. This effort has failed. The Commission draws this conclusion even though recognizing that the telecommunications industry is changing in significant ways. Such changes have yet to disturb the essential characteristics of USWC as a regulated provider of essential services in this jurisdiction: the well known aspects of a monopoly position in the relevant market, the trust relationship between utility and consumers, and the imposed constraints upon both prices charged for services and rate of return. As conditions change, the Commission may, in future dockets, conclude otherwise.

Without dispute, capital costs have declined since the previous rate of return decision of 11.8 percent, and even since the filing of direct testimony. Taken alone, this would argue for reduction in allowed return. But other compelling factors have a role to play. The record on risk-return comparability, while not

complete, on balance suggesting increasing risk; the questioned reliability of model results during unsettled moments in the economy and industry; the large, even contrary, difference in results obtained by witnesses for the Company compared with witness Compton for the Division using CAPM; the knowledge that the utility may to a degree be shedding certain utility characteristics; and the ambiguous record on expected behavior of stock price, are all influential considerations which must be evaluated in the context of a wide range of cost of equity results obtained by witness application of models. The Commission concludes there is no reason to grant an award at the upper end of the range, and indeed there are reasons why this would be error. The Commission is convinced a reduction in the current equity return, though advocated by witnesses for the Committee and the Division, would likewise be in error, given the risk implications of the changing industry and the status of the general economy in relation thereto.

The Company repeatedly stressed that its discretionary investment decisions are driven by profitability considerations, meaning in part that economic analysis, or business case analysis, is employed to rank alternatives. Implied at times and explicit at times was the message that jurisdictional rate of return allowed by commissions could be the determining factor. The rate of return on equity in Utah is 11.8 per cent, the lowest in the 14-state USWC service territory. The Company's witnesses labeled that rate unreasonable and made the connection between it and discretionary investment aimed for the state.

It is the fact that the earned rate of return on equity, as distinct from what is allowed, in Utah is among the highest in the 14 states, and has been so in recent years. The Company, however, argued that expected rate of return, based on allowed not past actual rate of return, is what is related to investment decisions. Nevertheless, the Commission notes that in the recent past when the allowed rate of return in Utah was among the highest, no discernably different pattern of discretionary investment decisions affecting Utah appeared. The Commission concludes that historical evidence does not reveal a clear relationship between either allowed or earned rate of return on equity on the one hand and the amount of discretionary investment in the state on the other.

Nevertheless, the Commission acknowledges the logic of the relationship between rate of return and investment decisionmaking. Regulation presumes a reasonable management. This is a time when states are in a sense competing for high-tech additions to and refinements of telecommunications plant and equipment. The Commission concludes that it is prudent to take these considerations into account when determining rate of return. Together, they argue for an addition to the cost of capital estimate produced by models.

The Commission is concerned enough with the factors enumerated in the discussion to raise the allowed return on equity capital to 12.2 percent from the existing 11.8, and finds this return to be reasonable.

2. CAPITAL STRUCTURE

Because debt is cheaper than equity, and interest expense on debt is tax deductible, the higher the debt ratio, other things being equal, the lower the cost of capital. The trade off is that increases in the debt ratio increase financial risk. It could be said that management should employ as much debt as is prudent, given this trade off, while regulators must be sure that too much equity is not employed in order to prevent an increase in the cost of capital that could be harmful to ratepayers. Company witnesses argued that because business risk is increasing, the debt ratio must be decreased in order to maintain bond ratings. A lower debt ratio decreases financial risk, maintains bond rating and protects shareholders. But the lower debt (higher equity) ratio costs ratepayers more, other things being equal, by increasing the cost of capital. This appears on this record to be true even though a higher bond rating reduces the cost of financing. Clearly, at least in principle, there is a financially prudent capital structure which could be employed for ratemaking purposes that would yield the lowest cost for ratepayers.

The proper composition of the capital structure for ratemaking purposes is one issue before the Commission in this docket. A related issue, whether to use USWC's or USW Inc's capital structure, captured equally as much attention. Neither is hypothetical, but the equity return recommendations may vary according to the choice since financial risk differs.

As pointed out in previous discussion, all witnesses acknowledged that USWC is a less risky entity than USW (lower business risk). Moreover, USW's capital structure risk (financial risk) is greater. The equity ratio is 60.4 percent for USWC, while for USW it is 48.2 percent. Company witnesses argued in favor of employing USWC's capital structure to determine overall cost of capital. A strong capital structure--more equity, in adverse times assures an acceptable bond rating (preferably AA), thus protecting both shareholder and ratepayer interests, they stated. Company witness Morin also argued that the equity ratio advocated by the Company is similar to that of peer companies; otherwise he would recommend use of a hypothetical capital structure. Committee witness Marcus testified that the variation in equity ratios between the two structures had not existed in previous rate cases, when in fact the ratios had been almost the same. He speculated that the divergence might be a transitional phenomenon, which should, with Commission encouragement (a lower equity award), disappear. Witness Marcus urged the Commission to be aware of the parent company's ability to control the amount of equity in the capital structure of USWC, a wholly owned subsidiary. Witness Compton generally supported use of USWC's capital structure, asserting that an equity ratio of approximately 60 percent is not unexpectedly high. He noted that a hypothetical structure with 55 percent equity would be acceptable and called attention to the lack of preferred stock in the capital structure though it is usually found in that of the energy utilities. In total the equity share may only appear high, and, therefore, Dr.

Compton supported maintenance of a AA bond rating, which he associated with the higher equity ratio.

No witness advanced a hypothetical capital structure in this docket. Each was confident that an actual capital structure, either USWC's or USW Inc.'s, could, with justification, be employed. In this case, the Commission finds that the weight of the evidence supports a higher equity ratio found in the USWC capital structure. As with the equity award decision, there are compelling arguments that this is an unsettled time, that business risk may be increasing, and that bond ratings may be jeopardized by a low equity ratio. All witnesses supported use of USWC's capital structure for determination of the overall rate of return. Witness Marcus, however, did tie his recommended equity return to the capital structure--11.3 percent if USWC's; 11.8, if USW Inc.'s--to alert management that the Commission should tolerate a divergence in the two capital structures only for a short period of time. The Commission finds that USWC's capital structure, composed of 60.4 percent equity and 39.6 percent debt, is reasonable for purposes of determining the overall rate of return to be granted in this docket. At the allowed equity return of 12.2 percent, this produces an allowed overall rate of return of 10.93 percent.

D. SUMMARY

The actual 1990 intrastate results of operations as well as the positions of the parties with respect to the determination of revenue requirement are summarized and presented in

Table 1 below. The unadjusted actual 1990 results excluding imputed directory revenues show the Company earned a rate of return on equity equal to 13.35 percent, exceeding the 11.80 percent allowed rate of return on equity used to establish the rates in effect during 1990.

The Company's interpretation of the October Stipulation and its recommended adjustment to depreciation expenses had the effect of reducing the rate of return on equity expected to be earned during the test period to 11.33 percent. Given its recommended 13.5 percent allowed rate of return on equity, the Company had proposed to increase revenues by \$9,804,000.

The effect of the Division's and the Committee's adjustments was to raise the rate of return on equity expected to be earned in the test period to 16.57 percent and 17.19 percent, respectively. Given an 11.35 percent allowed rate of return on equity, the midpoint of the range recommended by Division witness Compton, the Division had proposed to decrease revenues by \$23,434,000. Given an 11.30 percent allowed rate of return on equity, recommended by Committee witness Marcus for the US West Communications capital structure, the Committee had proposed to decrease revenues by \$26,527,000.

The Commission's findings with respect to the Stipulation and adjustment to depreciation expenses result in increasing to 16.58 percent the rate of return expected to be earned in the test period. Given the Commission finding of a 12.20 percent allowed rate of return on equity, the Commission finds that revenues should be reduced by \$19,799,000.

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TABLE 1
REVENUE REQUIREMENT
 Summary of the Positions of the Parties
 and Commission Decision
 1990 Utah Intrastate Results of Operations
 Test Period (\$000)

	1990 Actual (Excl. Directory Revenues)	Company	Division	Committee	Commission
1. Total Operating Revenue	315,736	313,637	320,000	313,268	310,268
2. Total Operating Expense	252,016	253,143	240,675	237,491	240,199
3. Total Income Taxes	10,427	12,172	17,001	16,752	15,742
4. Other Income	-135	51	200	-463	-463
5. RATEMAKING INCOME	53,158	48,373	62,593	64,564	62,864
6. RATE BASE	457,107	464,890	461,673	463,126	463,126
7. Earned Rate of Return on Rate Base	11.63%	10.41%	13.56%	13.94%	13.57%
8. Earned Rate of Return on Equity	13.35%	11.33%	16.54%	17.18%	16.57%
9. Allowed Rate of Return on Equity	11.80%	13.50%	11.35%	11.30%	12.20%
10. Allowed Rate of Return on Rate Base	10.69%	11.71%	10.41%	10.38%	10.93%
11. Recommended Change in Revenues		\$9,804	(\$23,434)	(\$26,507)	(\$19,799)

Absent the two interim rate decreases of this docket, revenues in the test period would be \$333,217,000. With the June 22, 1990 interim reduction of \$10,711,000, the January 1, 1991 interim reduction of \$8,238,000, and the final decrease of \$19,799,000, test period revenues will have been decreased by a total of \$38,748,000 to \$299,469,000, representing an 11.4 percent decrease in prospective rates as a result of this docket. The Commission also notes the 1990 test period revenue requirement is about 6 percent lower than the

1988 test period revenue requirement of \$319,047,000 found in Docket No. 88-049-07, despite the growth in access lines and minutes of use during that period.

III. DISCUSSION, FINDINGS, AND CONCLUSIONS WITH RESPECT TO
REVENUE SPREAD AND RATE DESIGN

A. COST-OF-SERVICE

1. BACKGROUND AND OVERVIEW

Since divestiture in 1984, the Commission has accorded a rising priority to cost-of-service studies in ratemaking decisions. There have been three general rate cases since divestiture, Docket Nos. 84-049-01, 85-049-02 and 88-049-07. In both Docket Nos. 84-049-01 and 85-049-02, the Commission stated that the relationship between cost incurrence and service provision was inadequately explored and the respective records were inadequate for pricing decisions. As a consequence, the Division was requested to provide the Commission with telephone cost-of-service studies.

In Docket No. 88-049-07, the Division submitted its cost-of-service model, termed DCOS, for its first review by the Commission. DCOS was created over a two-year period from the Company's 1987 prototype Management Marketing Information System cost-of-service model, termed MMLS. The DCOS model and disputes concerning its study methods were described on pages 89-111 of the Report and Order issued October 18, 1989 in Docket No. 88-049-07.

As a result of the Commission's review of the initial DCOS model, the Company and the Division were ordered in Docket No.

88-049-07 to investigate several issues. The Commission also invited the Committee to participate. The parties held several meetings, some of which the Commission Staff attended. On April 6, 1990, the Company, the Division and the Committee submitted their Joint Report to the Commission. Cost-of-service issues addressed in the Joint Report included a peak method for allocating traffic sensitive (TS) costs, a method for allocating non-traffic sensitive (NTS) costs, an examination of DCOS product definitions and corresponding tariffed rate elements, the correlation of DCOS information with the test period employed in the determination of revenue requirement, and future updates of the DCOS model. The Joint Report detailed the positions of the parties on the above issues and identified areas of agreement and/or disagreement. The most significant disagreement concerned the allocation of non-traffic sensitive costs.

The prototype MMIS model has since been abandoned by the Company and replaced with a new model designed for use throughout all 14 states served by the Company. In addition, basic changes had been made in the new MMIS model to incorporate the new USOA accounts and procedures adopted by the FCC. For these reasons, the Division had to virtually reconstruct its DCOS model subject to its own resource constraints and the time limitations imposed by this case. The Division's current version of the DCOS model basically duplicates the essential parts of the latest version of the Company's MMIS model.

Every revenue, expense and investment category or portion thereof that requires a separate direct assignment or allocation is shown in the DCOS model. Within DCOS, 946 Utah intrastate investment

and expense items and a number of revenue items are assigned or allocated to 54 product groups. The DCOS model employs 19 exogenous allocation factors developed from external data and special studies and 139 allocation factors developed within the model.

The current version of DCOS again contains an investment translator which is used to reconcile Central Office Equipment and Outside Plant investments contained in separations categories with the amounts booked in Uniform System of Accounts (USOA) subaccounts, the latter being inputted into the cost-of-service model.

The current DCOS study utilized 1989 actual revenues and expenses. The rate base utilized was obtained from a 12-month average of 1989 actual investments.

The Company did not file its own embedded cost-of-service study. The Company stated that since its MMIS model is an integrated 14-state model, it is therefore limited in its ability to accommodate every state specific requirement. Furthermore, the Company agreed in Docket No. 88-049-07 to use the general format of the DCOS model in future rate cases and to argue for modifications where appropriate.

2. UNDISPUTED ISSUES

Upon review of the DCOS study submitted by the Division in direct testimony, the Committee recommended several modifications to which the Division agreed. The Committee recommended that customer deposits be excluded from and cash working capital be included in the determination of rate base, consistent with the treatment of these items in the revenue requirement phase of this case.

Some private line investments had been included with message service investments and were subsequently allocated to message service products. The Committee referred to detailed separation reports in which the private line investments were separately identified thus providing for their allocation to private line products.

Investments in Non-Pair Gain Circuits, a category of Central Office Equipment, had been allocated to access products only. The Committee recommended these investments be allocated to all products.

Automatic number identification equipment which identifies and records message billing data, as well as other types of local switching equipment which are only required for or used proportionately more for message-rated toll and switched access services were allocated to flat-rated local products. The Committee recommended that these costs be allocated to toll and switched access products based on the number of messages for which billing data is available.

The additional circuit equipment necessary to provide the higher quality and more costly transmission characteristics required by data and other private lines had been allocated uniformly to all types of access lines. The Committee recommended that these costs be allocated to the private line products.

The Committee also recommended that 50 percent of local TS investments be allocated based upon relative number of peak calls and 50 percent based on relative duration of peak calls.

3. DISPUTED ISSUES

a. Allocation of Imputed Directory Revenues

In Docket No. 88-049-07, the Commission found with the Committee that the imputed Yellow Page directory revenues were to be included in the residential local exchange access products (DCOS Product Nos. 5 and 7).

In the current case, the Company has again recommended that imputed directory revenues should not be allocated to local exchange access products but should be displayed separately. The Company argued directory revenues are generated by business customers purchasing Yellow Pages advertising and are not produced by residence customers. To allocate imputed directory revenues to local exchange access products would blur the study results and undermine the usefulness of the cost-of-service study.

The Division recommended that imputed directory revenues be allocated to local exchange access product groups (DCOS Product Nos. 1, 3, 5, 7, 12, 14, 21, 23, 30, 33) based on the relative number of local exchange access lines. The Division argued that all local exchange access lines and trunks create directory listings and all lines and trunks should be credited with imputed directory revenues.

The Committee, consistent with the prior Commission order, recommended that the directory revenues remain with the residential local exchange access products (DCOS 5, 7). The Committee argued that Judge Greene allowed the local operating companies to retain the directory services in order to provide support for universal service. In the "Modification of Final Judgment," dated August 24, 1982, Judge

Greene stated that Yellow Pages directories were left with Bell operating companies rather than AT&T for the purpose of providing support to local exchange rates, since the loss of revenues from directory advertising would require large rate increases for local service. Further, "...large rate increases of this type will reduce the number of households with telephones and increase the disparity between low-income and well-off citizens. This result is clearly contrary to the goal of providing affordable telephone service for all Americans." (US v AT&T, 552 F.Supp. 131 (1982), p.193-4)

From Judge Greene's statements it is not clear whether the objective of retaining directory revenues with local operating companies is to promote lower rates for both residential and business customers or residential customers alone. Under the Division's recommendation that imputed directory revenues should be allocated based on the relative number of access lines, and since residential customers account for 67 percent of all 1990 access lines, the Division provides a fair interpretation of Judge Greene's intentions.

The Commission therefore finds that imputed directory revenues should be allocated to all residential and business local exchange access products based on the relative number of local exchange access lines.

b. Weekend Adjustment to Peak Usage Allocation Factor

In Docket No. 88-049-07, the Commission ordered the separation of usage or traffic sensitive (TS) costs into set-up and holding costs, with set-up costs allocated based on the number of calls during the peak period and holding costs allocated based on the

duration of calls during the peak period. In its Report and Order of October 18, 1989, the Commission also ordered the Company to design and develop a new statewide valid sample for the Subscriber Line Usage Study (SLUS). The reports were to show minutes of use for each intrastate product on an hourly basis by day of the week in order to identify an appropriate peak period for allocation purposes. The new SLUS data required for full implementation of the DCOS model is still in the developmental and collection stage. The Company has yet to provide 1990 data from the modified SLUS as ordered by the Commission. Also the 1988 and 1989 data were flawed due to training problems incurred when switching the SLUS program from decentralized to centralized control and operation. Therefore the only valid data available for determination of relative peak use was the 1987 SLUS data provided in Docket No. 88-049-07 which identified minutes of use for intrastate products by hour of the day but not by day of the week.

Stating there was no reliable information to do otherwise, the Division determined the peak period to be the three busy hours of each day including weekends. By default, the Division obtained the relative minutes of use during the peak period from the 1987 SLUS data submitted in Docket No. 88-049-07.

The Committee argued that residential customers make a higher percent of their calls during weekends than business customers. Ignoring this difference by treating weekend calls like week-day calls, as the 1987 SLUS does, would over-allocate costs to residential products and under-allocate costs to business products.

As evidence indicating that the weekend is off-peak, the Committee referred to local measured service rates, and intrastate and interstate toll rates, all of which have discounts which apply during the weekend hours.

The Committee recommended that the variation in weekday versus weekend toll usage be used as a proxy to remove the effect of weekend usage from the determination of the peak period. The Committee argued that any error in the study results induced by the use of toll information to approximate a weekday peak period would be less than that due to ignoring the difference in usage between the weekday and weekend periods. While the Division agreed with the philosophy of the CCS recommendation, the Division argued that toll usage was not an accurate reflection of local usage. The Division recommended proceeding on this issue later in the year, after the case, to which the Company agreed.

The Company has had sufficient time to revise and submit a currently valid subscriber line usage study. The impact of the Committee's recommendation is significant and cannot be ignored. The Commission therefore finds with the Committee that for purposes of this case, toll usage information should be employed to distinguish weekday from weekend usage in the determination of relative use during the peak period.

c. Assignment of the End Use Line Charge (EULC) Revenues and Allocation of Non-Traffic Sensitive Costs

In Docket No. 88-049-07 the Commission stated that exchange access supports and is inseparable from all uses made of the telecom-

munications network. As a consequence, the Commission found that the local exchange access products (DCOS Product Nos. 1, 3, 5, 7, 12, 14, 21, 23, 30, 33) should be allocated only a portion of the non-traffic sensitive (NTS) costs. Therefore a portion of NTS costs must be reallocated to products other than local exchange access. The Company, the Division and the Committee agreed that a portion of the NTS costs be reallocated to toll usage and switched access products (DCOS Product Nos. 18, 20, 47, 54-57).

In the DCOS model, all categories of Central Office Equipment and Outside Plant investments were allocated based on usage or were directly assigned with the exception of three categories which constituted NTS investments: Loops, Pair Gain and Non-Pair Gain Circuit Equipment. Investment in Loops, totalling \$426,708,706, is a category of Outside Plant, and investment in Pair Gain Circuit Equipment, totalling \$39,883,557, is a category of Central Office Equipment. Both were allocated based on adjusted relative length of 1989 access lines. Investment in Non-Pair Gain Circuit Equipment, totalling \$41,414,337, is a category of Central Office Equipment and was allocated based on adjusted relative number of 1989 access lines. These three categories, the NTS investments, accounted for 52 percent of Central Office Equipment and Outside Plant in Service, and 38 percent of total Plant in Service.

There were two issues in dispute. The first was whether the revenues obtained from the End User Line Charge (EULC) and associated NTS costs were to be assigned to local exchange access products or assigned to interstate switched access products. The second issue

concerned the adjustment of the NTS allocation factors so as to reallocate a portion of NTS costs from local exchange access products to toll usage and switched access products.

In the FCC's Part 36 separations procedure, the interstate Basic Allocation Factor (BAF), formerly the Subscriber Plant Factor (SPF), was used to allocate NTS costs to the interstate jurisdiction. For 1990, the Company's interstate BAF equalled 28.4768 percent. The End User Line Charge (EULC), formerly the Subscriber Line Charge (SLC), and the interstate Common Carrier Line Charge (CCLC) are rate elements authorized by the FCC for interstate toll and switched access services. The EULC is a flat monthly charge paid by end-users of access lines to the Company for interstate toll service. The interstate CCLC is a usage-based charge paid by interexchange carriers to the Company for switched access service to originate and terminate interLATA calls using the Company's facilities. The EULC and the interstate CCLC rate elements are designed to collect revenues to cover the interstate portion of local exchange costs, including the NTS costs allocated to the interstate jurisdiction based on the interstate BAF.

Since EULC revenues are collected from end-users of access lines, the Division recommended that these revenues be directly assigned to the exchange access products from which they originated. Under this approach, the revenues collected from the interstate EULC rate element were assigned to local exchange access products and the revenues collected from the interstate CCLC rate element were assigned to the interstate switched access products. Therefore the

Division recommended that one half of the NTS investments allocated to the interstate jurisdiction on the basis of the 1990 BAF be allocated to local exchange access products and the other half, or 14.2384 percent, be reallocated to the interstate switched access products. The Division also recommended that the NTS investments be reallocated to the intrastate toll usage and switched access products based on 1989 relative minutes of use, or 6.0477 percent and 0.6431 percent, respectively. In total the Division recommended that 20.9292 percent of NTS investments be reallocated from local exchange access to toll usage and switched access products.

The Company argued that if EULC revenues are assigned to exchange access products as recommended by the Division, then interstate switched access minutes of use relative to total minutes of use be used to reallocate NTS investments to interstate switched access products rather than an arbitrary one half of the interstate BAF. This resulted in a reallocation of 13.5625 percent of the NTS investments to the interstate switched access products rather than the Division's recommended 14.2384 percent. The Company agreed with the Division's recommendation that the reallocation of NTS investments to the intrastate toll usage and switched access products be based on relative minutes of use. In total the Company recommended that 20.2533 percent of NTS investments be reallocated from local exchange access to toll usage and switched access products if EULC revenues were to be assigned to local exchange access products.

Since EULC revenues are designed to cover a portion of interstate costs, the Committee recommended that the EULC revenues in

addition to the interstate CCLC revenues be assigned to interstate switched access products. As a consequence, the Committee recommended that all NTS investments allocated to the interstate jurisdiction based on the interstate BAF, or 28.4768 percent, be reallocated to interstate toll and switched access products. The Committee also recommended that NTS investments be reallocated to intrastate toll and switched access products based on 1990 intrastate BAFs for intrastate toll and switched access, or 11.8996 percent and 1.0402 percent, respectively. In total the Committee recommended that 41.4166 percent of NTS investments be reallocated from local exchange access to toll usage and switched access products.

The Company argued that if EULC revenues are assigned to interstate switched access products as recommended by the Committee, then relative minutes of use be used to allocate NTS investments to intrastate toll usage and switched access products, as recommended by the Division, rather than intrastate BAFs. In total the Company recommended 35.1676 percent of NTS investments be reallocated from local exchange access to toll usage and switched access products if EULC revenues were to be assigned to interstate switched access products. The Company also recommended that the reallocation of NTS investments to other than local exchange access products continue to be addressed in informal meetings between the Company, the Division and the Committee.

The recommendations of the parties with respect to the reallocation of NTS investments are summarized in the following table:

TABLE 2
REALLOCATION of NTS INVESTMENTS

	EULC Revenues in Local Exchange Access Products		EULC Revenues in Interstate Switched Access Products	
	Division	Company	Committee	Company
Interstate Toll & Switched Access	14.2384%	13.5625%	28.4768%	28.4768%
Intrastate Toll Usage	6.0477%	6.0477%	11.8996%	6.0477%
Intrastate Switched Access	0.6431%	0.6431%	1.0402%	0.6431%
Subtotal	20.9292%	20.2533%	41.4166%	35.1676%
Local Access	79.0708%	79.7467%	58.5834%	64.8324%

The Division's recommendation mixes both interstate and intrastate revenues and costs whereas the Committee's recommendation maintains a separation between interstate and intrastate operations. It is the latter approach which is more relevant for intrastate pricing decisions. The Commission therefore finds with the Committee that both EULC revenues and the current NTS investments allocated to the interstate jurisdiction as provided by the 1990 BAF be allocated to interstate switched access products.

Whereas this Commission has no authority over the determination of the NTS investments allocated to the interstate jurisdiction, the Commission does have authority over NTS investments allocated to the intrastate jurisdiction and the method by which the NTS investments are allocated among intrastate products.

Relative number and length of access lines are modified by relative minutes of use to provide a measurable, state-specific means

of sharing intrastate NTS costs among intrastate products. The original Subscriber Plant Factor was based primarily on a multiple of Subscriber Line Usage. The Basic Allocation Factor is based on an industry-wide average of interstate Subscriber Plant Factors. Thus to use intrastate BAFs would result in the allocation of intrastate NTS investments based on some multiple of industry-average intrastate usage rather than state-specific information.

The Committee argued that if usage is to be the basis for allocating NTS costs, then it is necessary to recognize the effect on usage of the different rate structures for local and long distance service. Since long distance service is on a message-rated basis, its usage is curtailed relative to flat-rated local service. Thus while BAFs are not state-specific, they do recognize the availability of the network for long distance service on a basis more comparable to local service.

The Commission is required by statute to determine rates based on state-specific cost information. To the largest extent possible, it is desirable that allocation factors be based on current state-specific information as well. While the Committee's point is well taken, information is insufficient to adopt the recommendation. Therefore, the Commission for the purposes of this case finds with the Division and the Company that the NTS investments be reallocated to intrastate toll and switched access based on state-specific relative minutes of use rather than intrastate BAFs.

d. Classification of Some of the Local Central Office Switching Equipment Costs as Non-Traffic Sensitive

It is acknowledged by all parties that a portion of the investment in local switching, a category of Central Office Equipment, is NTS. In 1989 investment in local switching totalled \$222,022,302 or 44 percent of the investment in Central Office Equipment. Prior to implementation of the latest USOA procedures, the telephone companies separately classified Central Office Equipment investments into TS and NTS categories. Thus the prior versions of MMIS and DCOS models differentiated between TS and NTS investments in local switching equipment, with TS allocated based on relative usage and NTS based on relative number and length of access lines. In the latest USOA procedures, the separate classification of investments in local switching equipment into TS and NTS categories has been eliminated and telephone companies are no longer required to make this accounting separation. As a result, USWC no longer maintains records that separate investments in local switching equipment into TS and NTS categories. Consequently, in neither current version of MMIS nor DCOS is the TS/NTS distinction made. The current separation of central office investments and expenses to interstate are based on usage. The Commission would prefer not to have NTS investments allocated based on usage but concludes that there is insufficient information to modify MMIS or DCOS at this time. We direct the Company and the Division to provide additional information to the Commission in order for us to determine if

separate identification and allocation of the NTS costs will be appropriate in the future.

e. Allocation of Accelerated Depreciation Expenses

The Company has stated that current Central Office Equipment provides adequate service and testified that the general growth in demand for services is the basis for equipment replacement. The Committee, however, testified that such equipment is replaced more rapidly to meet the demand for non-basic services than is necessary to provide basic services. Therefore the Committee recommended that the additional depreciation and amortization expenses caused by the accelerated replacement of central office equipment be allocated to the non-basic services.

The Division argued that keeping step-by-step offices in the network would retain higher overall costs and would maintain standard service to customers. The Division also stated that its recommended depreciation rates for Central Office Equipment were based only to a minor degree on the revenues from custom calling and other vertical services compared to other justifications. The Company also disagreed with the Committee's recommendation, terming it an implementation nightmare with respect to a cost allocation system.

The Commission rejects the recommendation of the Committee.

f. Allocation of Income Taxes

In DCOS, all income taxes are allocated to each product based on each product's allocated share of rate base. The Committee recommended that income taxes be allocated to each product based on

relative taxable income. In Docket No. 79-035-12 the Commission found the allocation of income taxes based on relative rate base "to be appropriate in cost studies designed to determine class revenue requirements where each class is assumed to earn the jurisdictional rate of return, and directs that this approach be used in the future." (Report and Order, April 12, 1982, page 9) To the extent a class or product does not earn the jurisdictional rate of return, income taxes allocated based on taxable income distorts information necessary for pricing decisions. The Commission affirms its earlier decision in Docket No. 79-035-12 and rejects the recommendation of the Committee.

4. SUMMARY

Two DCOS studies incorporated the undisputed issues and Commission findings with respect to the disputed issues as discussed above. The results of these two studies are provided in Tables 3 and 4. Table 3 aggregates into 9 broad market categories the results for the 54 product groups shown in Table 4.

Both studies were based on actual 1989 expenses and investments. The first study, termed Actual, was based on actual 1989 revenues. The second study, termed Proforma, annualized actual 1989 revenues to reflect the rate changes that have occurred between 1989 and the present, i.e. the revenue reduction ordered in Docket 88-049-07 effective November, 1989, and the revenue reductions resulting from the two interim reductions ordered in the current

docket, effective July, 1990, and January, 1991, respectively. Both studies used the 1987 SLUS data.

TABLE 3
AGGREGATE SUMMARY
COST-OF-SERVICE STUDY RESULTS
Rate of Return on Rate Base
1989 Revenue, Expenses and Investments

	Actual	Proforma*	DCOS Products
BASIC LOCAL EXCHANGE PRODUCTS			
RESIDENCE	10.98%	0.14%	5-8
BUSINESS	44.94%	29.93%	1-4, 21-24
COIN	-4.21%	-5.93%	9, 12-15, 61
OTHER	-22.03%	-23.88%	25,30,31, 33,34,36,37,40, 42,44,45R,46,60,62,65,66
	<u>16.01%</u>	<u>5.14%</u>	
INTRASTATE TRANSPORT PRODUCTS			
TOLL	33.28%	26.95%	17-20, 47, 49, 50
SWITCHED ACCESS	38.18%	33.54%	53, 55, 57, 64
PRIVATE LINE	-9.61%	-9.76%	38, 63R
	<u>19.94%</u>	<u>15.67%</u>	
INTERSTATE AND DEREGULATED PRODUCTS			
INTERSTATE SWITCHED ACCESS	15.50%	15.50%	51, 52, 54, 56 58
DEREGULATED	-108.46%	-108.46%	450, 630
	<u>12.84%</u>	<u>12.84%</u>	
OVERALL EARNED RATE OF RETURN	15.68%	9.46%	
OVERALL AUTHORIZED RATE OF RETURN	10.69%	10.93%	

* Proforma adjusts revenues for the rate reductions from 1989 to the present assuming quantity sold in 1989 is unchanged.

In Table 3 there are four broad markets for local exchange services consisting of residence, business, coin telephone, and other exchange services. There are three broad markets for intrastate transport services consisting of toll, switched access, and private lines. The remaining two broad markets are interstate switched access and deregulated services. The overall rate of return earned

TABLE 4
COST-OF-SERVICE STUDY SUMMARY RESULTS
DCOS Product Rate of Return on Rate Base
1989 Revenues, Expenses, and Investments

Aggregate	DCOS Group	Product	Actual		Proforma*	
			Revenues	ROR	Revenues	ROR
RESIDENCE	5	Residence - Flat Access	75,862,458	4.93%	58,975,782	-5.10%
LOCAL	6	Residence - Flat Usage	42,730,664	30.13%	35,778,838	16.63%
EXCHANGE	7	Residence - Measured Access	1,539,197	6.76%	1,255,199	-1.21%
	8	Residence - Measured Usage	655,294	87.43%	572,064	68.40%
BUSINESS	1	Business - Flat Access	42,303,713	70.41%	36,634,319	52.95%
LOCAL	2	Business - Flat Usage	21,130,844	20.45%	18,610,821	11.77%
EXCHANGE	3	Business - Measured Access	708,570	19.64%	620,964	6.88%
	4	Business - Measured Usage	647,698	524.48%	627,948	547.40%
	21	PBX - Flat Access	9,523,589	82.07%	7,587,556	52.81%
	22	PBX - Flat Usage	8,242,160	11.50%	6,177,570	-4.09%
	23	PBX - Measured Access	410,378	70.17%	340,403	48.72%
	24	PBX - Measured Usage	568,734	718.04%	542,109	750.00%
COIN	9	Public Telephone	6,176,321	-26.64%	6,176,321	-27.24%
TELEPHONE	12	Public Access Line - Access	708,553	46.56%	662,364	38.89%
LOCAL	13	Public Access Line - Usage	473,281	510.95%	468,661	553.52%
EXCHANGE	14	SemiPublic Coin - Access	459,714	-29.43%	412,200	-40.25%
	15	SemiPublic Coin - Usage	776,020	215.19%	771,906	224.17%
	61	Booth Advertising	347,692	1122.99%	347,692	1122.99%
OTHER	25	Centron I Features	2,323,156	-26.62%	2,324,419	-27.43%
LOCAL	30	Centron Custom - Access & Features	4,901,998	5.05%	4,929,238	5.26%
EXCHANGE	31	Centron Custom - Usage	1,391,851	-26.19%	1,048,473	-31.74%
	33	Centrex - Access & Features	565,020	-21.24%	565,332	-21.33%
	34	Centrex - Usage	430,459	-24.80%	396,535	-26.92%
	36	Info Services (976, 960, 900)	213,273	-56.00%	212,848	-56.86%
	37	Versanet	47,887	-33.39%	47,887	-33.39%
	40	Mobile	226,789	-44.57%	240,036	-42.71%
	42	Custom Calling	8,692,739	32.82%	8,697,460	32.67%
	44	Remote Call Forwarding	588,001	-26.11%	588,001	-27.77%
	45R	Regulated Time & Materials	17,106	-1563.61%	17,106	-1561.05%
	46	Inside Wire - Embedded	31	52.20%	31	52.20%
	60	Listing Services	4,540,630	-20.24%	4,474,692	-22.40%
	62	Emergency Services (911)	1,009,900	433.05%	1,009,542	427.07%
	65	Other Services	547,046	-166.64%	547,046	-166.70%
	66	ISDN	9,815	-157.60%	9,815	-157.62%
INTRASTATE	17	IntraLATA Inward WATS - Access	586,937	15.50%	553,375	11.44%
TOLL	18	IntraLATA Inward WATS - Usage	6,095,969	138.27%	5,612,926	122.14%
	19	IntraLATA Outward WATS - Access	208,392	6.80%	193,377	2.52%
	20	IntraLATA Outward WATS - Usage	1,627,518	51.87%	1,485,230	42.47%
	47	IntraLATA Message Toll & Options	63,117,125	34.20%	58,354,738	26.13%
	49	Operator Services	6,553,165	-10.61%	7,508,549	13.62%
	50	Directory Assistance - End User	3,818,093	-19.12%	3,805,312	-19.99%
INTRASTATE	53	Intrastate Billing & Collection	142,735	3281.50%	142,735	3281.50%
SWITCHED	55	Carrier Feature Group A&B	2,268,341	31.35%	2,119,917	26.13%
ACCESS	57	Carrier Feature Group C&D	2,790,550	33.42%	2,541,097	28.56%
	64	Contract Services (SNFA)	962,487	81.48%	962,487	81.48%
INTRASTATE	38	Private Line - Special Access	16,138,142	-8.74%	16,137,984	-8.79%
PRIVATE LINE	63R	Digipac	53,310	-70.69%	53,310	-70.69%
INTERSTATE	51	Directory Assistance - Carrier	3,561,605	229.65%	3,561,605	229.65%
	52	Interstate Billing & Collection	7,009,783	36.87%	7,009,783	36.87%
	54	Carrier Feature Group A&B	27,810,303	44.03%	27,810,303	44.03%
	56	Carrier Feature Group C&D	74,254,930	5.49%	74,254,930	5.49%
	58	Private Line	17,287,174	32.29%	17,287,174	32.29%
DEREGULATED	45D	Premise Service	5,182,328	-108.55%	5,182,328	-108.55%
	63D	Protocol Conversion	0	-31.17%	0	-31.17%
Overall Earned Rate of Return on Rate Base:			478,149,470	15.68%	436,248,338	9.46%
Overall Allowed Rate of Return on Rate Base:				10.69%		10.93%
Based on an Allowed Rate of Return on Equity of:				11.80%		12.20%

* Proforma adjusts revenues for the rate reductions from 1989 to the present assuming expenses, investments, and quantities sold in 1989 are unchanged.

on rate base shown in the 1989 Actual study was 15.68 percent as compared to the authorized rate of return of 10.69 percent.

The results of the 1989 Actual study showed comparable rates of return earned by business local exchange, intrastate toll and switched access services, all considerably above the overall earned rate of return. Residence local exchange service provided a rate of return approximately equal to the authorized rate of return. The remaining services, coin telephone, other local exchange and private line services all showed negative rates of return. Other local exchange services consist primarily of Centron and Centrex business services, custom calling features and listing services.

The results of the Proforma study reflect the spread decisions of Docket No. 88-049-07 and the two interim decreases of the current docket. The revenue reductions in Docket No. 88-049-07 were spread to reduce residential and business local exchange revenues by 17 percent and 10 percent, respectively, with intrastate transport services receiving none of the reduction. The two interim decreases have been spread to produce an equal percentage reduction for residence and business local exchange and intrastate toll and switched access revenues. The usefulness of the Proforma study is severely limited in that the effects of time and growth on operations have been ignored. Only prices have been updated to the present, effectively yielding proforma revenues as the product of 1989 usage and 1991 prices.

The determination of jurisdictional revenue requirement was based on a stipulated 1990 test year, the DCOS studies were run on 1989 information, and the relative usage information employed in the DCOS studies were from the 1987 SLUS data. This lack of consistency

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of information among the phases of the ratemaking process is unsettling to say the least. The Commission strongly encourages the parties to provide ratemaking information from a consistent time period.

The Commission finds that the Company is to provide the Division with 1990 SLUS information and other 1990 information necessary to allow the Division to perform a DCOS study based on 1990 actual results of operations consistent with Commission findings in this docket. The Division shall perform and report the results of the 1990 DCOS study with the Commission and make available the study to the Committee and any other interested party. The results of the forthcoming 1990 DCOS study shall be employed by the Division to evaluate Company tariff filings. No tariff filings will be considered in the absence of 1990 DCOS analysis.

The current version of the DCOS model does not separate recurring from nonrecurring revenues and expenses. To aid in pricing decisions, the Commission encourages the Division to investigate incorporating this separation in future versions of the DCOS model.

B. REVENUE SPREAD AND RATE DESIGN

The Commission's determination of utility product or service prices (rates) is guided by ratemaking or pricing objectives. Certain of these objectives are attained when rates are based on the costs of providing the services. Cost-based rates thus are means to other ends.

It is the fact that the several pricing objectives may conflict; that is, the attempt to attain one may lead away from attainment of another. The Commission's pricing decisions therefore

inherently involve trade-offs. They are balancing decisions. If basing rates on cost of service is one primary consideration, another, at times leading to opposite pricing choices, is setting prices to attain the social goal of universal service. Nevertheless, cost of service information must be the starting point, and, assuming the costing information is good enough to permit it, the manner in which prices deviate from cost of service will give some indication of the policy decisions the Commission has made.

Circumstances facing the industry and the Company today have both changed the priority of the ratemaking objectives and added other considerations. The Company thus has argued that service prices must be a function of two things, long-run incremental costs, as a floor below which prices should not fall, and a market-determined ceiling, above which prices would be self-defeating. Market analyses, including demand elasticities, thus have a newly acquired importance.

In the long transition from value-of-service pricing to cost-of-service pricing, concerning which the Commission has commented previously, the type of cost information to be employed, embedded or incremental, has been disputed vigorously. As the preceding section makes clear, embedded cost-of-service information, developed under this Commission's careful guidance, continues to hold sway in this jurisdiction. Moreover, it has an increasing importance for spread decisions, for regulatory responses to anticipated tariff restructure requests or new product filings, and as the means by which cross-subsidization claims will be addressed.

The Company's long-run incremental cost information has not been subject to the same sort of rigorous regulatory scrutiny, and

has carried less weight in pricing decisions. In this docket, the Company testified that only residential dial tone line is priced below long-run incremental cost. But given the Commission's decision in Docket No. 88-049-07, that the dial tone line rate is designed to recover only a portion, not all, of the non-traffic sensitive costs of the local loop, such information is insufficient to effect a price change in any event.

Parties have testified to the importance of market relationships among various services, and these relationships mean, in their view, that if the price of a particular service is changed, other related service prices must change in proportion. Relationships between business and residential, and among toll, switched access, and extended area service, are principal among these. There is on the record, however, scant evidence other than the anecdotal, concerning market characteristics either in general or in specific.

In sum, embedded and incremental costs, relationships among services, market analyses, and social objectives such as universal service, guide pricing decisions. The quality and reliability of information on the record about each of these, however, is far from being equal, as will become apparent in the following discussion of individual pricing decisions.

USWC presented the testimony of Lloyd Tanner, Donald K. Mason, Dr. H. Craig Petersen, Mary Ellen Young, Leslie D. Lanksbury, Dallas R. Elder, Dan A. Purkey, Timothy F. Young, Robert H. Brigham, and Steve L. Hill. Witnesses for the Division were Larry Fuller and Lowell E. Alt; for the Committee, William Dunkel; and for MCI, Dr. Nina Cornell.

1. EXTENDED AREA SERVICE (EAS)

The Company testified that extended area service rates should be reduced by 13.5 percent. Resulting rates would be in excess of long-run incremental costs, as shown by Company studies. The Company also asserted that such a reduction would not increase localized pressures for this service since rates vary by area. According to the Division, EAS charges for business customers are in some minor respects inequitable, creating the need for adjustments that can and should be made in this docket. The Committee's position is that EAS charges should be reduced by the same percentage as the Commission finds appropriate in this docket for residence and business basic exchange service prices.

The Commission did not reduce EAS rates in the last rate case. The Division's DCOS model does not show EAS as a separate service category. The embedded costs of EAS are not shown separately on the record but are included in residence and business usage categories, both of which show more than adequate returns. The Company's long-run incremental costs have not been thoroughly analyzed by the parties, though its testimony that proposed reductions would yield prices above such costs was not disputed. Key to this pricing decision is the long-standing relationship tying EAS prices to those for toll and switched access services and the parties' testimony that prices for each should be reduced by the same percentage. The Commission has been concerned that EAS not be priced to encourage a shift from toll. Testimony indicates this would not be expected to occur should reductions be such as to preserve the relationship. Though lacking both cost and market information of the desired specificity, the Commission finds the weight of the evidence supports.

a reduction of EAS prices. Considering the magnitude of the reduction in revenue requirement ordered in this docket and the relationship among the services, the Commission finds a reduction of all EAS rates by 11.8 percent to be appropriate. The Commission further finds the minor adjustments to remove EAS from certain business services, as proposed by the Division, to be appropriate.

2. TOLL SERVICES

Proposals to revise and restructure aspects of Message Telecommunications Service (MTS), OutWATS, and 800 Service were presented by the parties. The Company proposed to combine MTS mileage bands and to reduce generally the rates for the first minute and each additional minute of use. This would simplify the rate structure and, by making proportionately greater rate reductions in the longer mileage bands, bring rates closer to cost of service. It would also reduce the disparity between intra- and interstate rates. Based on its cost-of-service and market analysis, the Division supported a reduction in and restructure of these rates. According to the Committee, its cost-of-service analysis does not support a reduction of MTS rates, which earn a return below the average for all services and which are low relative to similar rates in other states. Moreover the service is growing rapidly, stated the Committee. It did not oppose the restructuring of mileage bands, however.

The Company proposed to revise OutWATS usage rates and to decrease the access line charges in response to what it styled as competitive pressures. The Division was in agreement. The Committee's cost analysis indicated no basis for rate reduction and

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its witness testified that the decline in OutWATS volume owed partly to USWC's toll volume discount services.

The Committee testified that the return shown by cost-of-service analysis for 800 Service was much higher than that for either OutWATS or MTS and therefore did not oppose the reduction and restructure proposed by the Company and supported by the Division.

The Commission did not reduce toll rates in the last rate case except as a consequence of the equal-percentage spread of the interim rate reduction. There is an intuitive but not carefully examined relationship among toll, switched access, and EAS. DCOS results indicate that toll services are overearning. These overearnings, as indicated by the Division's DCOS Model, are derived from the usage priced services. The flat access portions of these services are not earning as much as most other services. The Commission finds that preserving the relationship between toll, switched access, and EAS requires a reduction in toll similar to that for EAS, that is, an 11.6 percent reduction. The Commission further finds the restructuring of toll, proposed by the Division, and of OutWATS and 800 service (inward WATS usage) rates proposed by the Company, and supported by the Division, and not contested by the Committee, to be reasonable.

3. SWITCHED ACCESS

The Company proposed a number of changes in switched access rates. In order to encourage carriers to seek customers more distant from their points of presence, for example, rural customers, the Company would reduce rates in the longer distance mileage bands while increasing them in the four shortest ones. Because the difference

between the local switching rate elements LS1 and LS2 is being phased out by the FCC, the Company argued for its elimination in this jurisdiction as well. The intrastate Carrier Common Line Charge (CCLC) should be reduced, according to the Company, as a movement toward a target level, which is based on Subscriber Line Usage (SLU). Moreover, the intrastate CCLC rates for the closed end of WATS and 800 usage should be removed, stated USWC, in order to discourage switched access network bypass. In a move to bring installation charges in line with costs, and to be consistent with interstate tariffs, the Company proposed to restructure certain identified local transport nonrecurring rates. The Division generally supported the Company's proposals, with the caveat that usage rates should produce returns consistent with toll services. The Committee argued that prices should remain as set following the January 1, 1991 rate reduction. If this were done, the CCLC could be removed from the closed end of WATS and 800 services since CCLC revenues would be lost in any event if large customers shifted to USWC private line service. A revenue-neutral rate restructuring would also be acceptable, stated the Committee.

The Commission accepts the relationship between toll, switched access, and EAS as the rationale for reduction in switched access rates, given the reduction in toll and EAS rates to be ordered herein. The Commission finds the proposed restructuring of switched access services to be reasonable, and further finds that switched access rates should be reduced by 11.7 percent.

4. PUBLIC COMMUNICATION SERVICES

To cover what it termed direct and imputed costs, the Company proposed an increase in the local coin message charge from \$0.25 to \$0.35. Arguing that the Commission should give USWC's cost study no weight because it is defective, the Committee would maintain the \$0.25 local payphone charge. According to the Committee, a large proportion of payphone revenues are derived from toll, access, and other non-local services which that study does not consider. The Division also recommended against raising the coin rate, strongly objecting to USWC's attempt to impute its competitors' rates as costs of providing coin service, and arguing that its cost study failed to include important categories of revenues.

The Commission finds that the cost-of-service analysis of coin service presented by the Company is inadequate. There is no support on the record for an increase in the rate for coin service. Furthermore, there are public interest reasons why coin rates should not be increased even if shown to be underearning. The Commission finds that the \$0.25 coin rate should be retained.

5. RESIDENCE LOCAL EXCHANGE

The Company emphasized that residence rates have been reduced, on a percentage basis, considerably more than other services since 1987 and therefore recommended that dial tone line and usage rates be returned (raised) to the levels in effect prior to the January 1, 1991 interim rate reduction in this docket. The universal service goal cannot be used to rationalize further reductions, the Company asserted, and called the Commission's attention to the fact that any reduction in EAS rates would benefit residence subscribers. The

Division's DCOS analysis provided support for maintaining these rates at the January 1, 1991 level, it testified. The Committee argued for further reduction in residence rates based on universal service considerations, amplified by claimed linkage between such rates and economic development and quality of life improvements. Local exchange services are the foundation for most other services, the Committee noted, and in general recommended further, equal percentage reductions from January 1, 1991 levels for residence and business local exchange and EAS rates.

The Commission is relying on the DCOS analysis presented by the Division and the Committee in this docket to support reduction in rates of various services. DCOS displays the results of past pricing decisions, indicating earnings by service categories. On this basis there is no showing that residence rates should be further reduced. The Universal Service implications of reducing residence recurring rates are ambiguous at best, and are therefore an insufficient argument for further reduction. The Company argued that its long-run incremental cost analysis shows that residence dial tone line service is priced too low. The Commission notes, however, that this cost analysis does not include an appropriate allocation of non-traffic sensitive costs, as determined in Docket No. 88-049-07, and has otherwise not been accepted by this Commission. On balance, the Commission finds that further reduction of residence recurring rates is not warranted at this time.

6. BUSINESS LOCAL EXCHANGE

USWC testified that the business dial tone line rate should be reduced to \$15.80 and argued that usage and related service rates

should be returned to June, 1990 levels, in order to achieve better alignment with residence rates. The Division testified that business rates should be reduced sufficiently to reduce the business-residence ratio to 2:1. This would require a reduction in dial tone line rate to \$15.00, a movement justified by much higher than average earnings, as shown by the DCOS results, and promotion of future business service efficiencies. The Committee argued that basic exchange rates should be maintained at January 1991 levels, then reduced a uniform percentage, but yielding no change in the prevailing business-residence ratio. That ratio can be justified on several grounds the Committee stated.

As determined by the Division's DCOS analysis, business dial tone line is earning substantially more than most other services. There is no other evidence on the record to suggest that a reduction in this rate would be inappropriate, and there is testimony from both the Division and the Company that it should be reduced. In past dockets the Commission has accepted a business-residence ratio greater than two based on assumptions such as business drives modernization of the network more than residential and business usage comes at the peak and therefore drives costs. Evidence suggests that this is still appropriate. The DCOS analysis does not indicate a need to reduce the business usage rate, other than as will occur owing to the EAS rate reduction to be ordered herein. The Commission finds that business dial tone line rates should be reduced 11.8 percent.

7. OTHER BUSINESS AND RESIDENTIAL SERVICES

The Division recommended increasing the price of the hunting charge to \$4.00 per line in order to maintain a proper relationship between business service and trunk service. The Company and the Committee agreed with this recommendation.

Hunting Increment and Open Switch Protection rates have recently been reduced as a result of the equal percentage spread of interim rate decreases. The Commission finds that the Division's recommendation should be adopted.

8. PBX TRUNK SERVICES

Both the Company and the Division recommend an unbundling of the hunting element from the Companion Line trunk rate and pricing this element equal to the hunting increment for business services. The Committee did not object to this recommendation. The Commission finds this is consistent with previous decisions which unbundle elements of telecommunication services and is a step toward the building-block approach recommended by MCI. The Commission further finds that one-way-out trunks should be priced the same as two-way trunks with hunting as the Division has proposed.

9. OBSOLETE EXCHANGE SERVICES

The record contains evidence that it is more costly to provide multi-party service than to provide one-party service. One-party service is a superior alternative, makes the network operate more efficiently, and is a standard this Commission has established for telephone service in Utah. Four- and eight-party service currently receives a 20 percent discount from one-party service rates. No

party recommended changes in the rates for these services. The Commission, however, desires to further examine the pricing rationale for multi-party and other obsolete services, and encourages the parties to address these issues.

10. NONRECURRING SERVICES

The Company, the Division, and the Committee offered similar recommendations for pricing certain nonrecurring services, such as assigning and changing numbers, installation charges, and temporary suspension of service, with the exception that the Committee recommended lower residential installation charges. The Committee argued that installation charges have been a barrier to the attainment of Universal Service and have prevented individuals who do not qualify for Lifeline or Link Up America programs from receiving telephone service.

One of this Commission's goals is promotion of Universal Service. The only compelling testimony concerning price as a barrier is that concerning the adverse effects of nonrecurring charges. Therefore, the Commission finds that the Committee's recommendation to reduce residence installation charges is reasonable and should be adopted. The Commission finds that the remaining nonrecurring charge recommendations of the parties are reasonable and should be adopted.

This concludes the Discussion, Findings and Conclusions concerning rates for services for which the parties explicitly recommended changes. The Commission is aware that the tariff rate elements bear relationships such that these deliberate changes will cause many other changes not addressed either in testimony or in this

section. All of these changes will be displayed in a final table to be attached to this Report and Order.

IV. NETWORK MODERNIZATION

A. INTRODUCTION

In this case the Company has submitted a proposal for modernization of its network in conjunction with its incentive regulation plan. According to Company witness Phillip S. Selander, the proposed modernization investments will be "a beginning or seed for the network of the future [and] they will give us the fiber optic and digital building blocks from which we can expand." The modernization plan would accelerate the installation of new central office switching and interoffice facilities in order to support the wide variety of capabilities and services that the network of the future may require. Thus, Company witnesses testified that the modernization plan is an important investment in Utah's future.

B. DESCRIPTION OF THE PLAN

The modernization plan, as presented by the Company, is primarily aimed at upgrading rural central offices and laying a fiber optic network to facilitate telecommunications for educational, governmental and hospital use as well as for residential and business customers. This would permit high-speed, high-capacity data transfer and accommodate two-way video transmissions in support, for example, of "distance learning." The upgrade would improve service for rural customers, the Company stated.

The modernization plan the Company originally filed on March 2, 1990, called for \$103 million in additional capital to be invested in Utah. \$52.46 million of the investment is for the replacement of 46 electro-mechanical central office switching equipment with digital switching equipment and the remaining \$51.67 million is for new interexchange fiber optic cable. When in place, according to the Company, high capacity transmission would exist from Brigham City to Cedar City, with digital radio extensions to Logan, Price, St. George and Vernal. The plan also included the construction of local fiber networks to connect central offices to universities, colleges and high schools. The Company stated that all projects would be completed within 54 months from the date of the Commission's order in this docket.

The Company's proposed plan was revised in response to testimony by the Division and the Committee, and by the Company's conclusion that five of the central offices in the original plan and transmission from Brigham City to Logan would hit "hard triggers", i.e., growth would exhaust capacity, requiring an immediate upgrade in order to maintain service. The Company's witnesses Robert C. Fuehr, Kirk R. Nelson, and Phillip S. Selander, in later filings and oral testimony, described the Company's revised modernization proposal. The revised plan proposed an upgrade to digital technology of the 41 remaining electro-mechanical central offices. The central office upgrade and facility augmentations needed to support such upgrades to digital technology were estimated to cost \$36.35 million on a total state basis and \$25.76 million on an intrastate basis, over a five-year period.

The second part of the revised plan is an expansion of the fiber optic and digital infrastructure "backbone" so that it runs from Logan to St. George, with upgraded digital microwave extensions to Vernal and Price. The Company consented to the Division's recommendation that the fiber optic extensions in support of higher education and distance learning, i.e. local fiber optic loops from central offices to every college, university and high school, would be installed only when economical. The estimated capital cost of the fiber extension is \$21.5 million. The commitment to lay fiber cable to all colleges, universities and high schools and school district offices when economical requires the investment of \$33.88 million in discretionary capital.

C. BENEFITS OF MODERNIZATION

All parties to this case agree that there are substantial benefits to be gained from modernization in general and the Company's proposed modernization plan in particular. Mr. Fuehr testified that "communications will become an even more critical link than it is today in the economic well-being and development of a highly mobile and technical society.... Telecommunications will play [a role] in enhancing the global competitiveness of Utah businesses." Company witness Dr. Davidson testified that in order to remain economically competitive, states would have to upgrade their telecommunication networks. He alerted the Commission to the consequences of inadequate investments in new technology: "Without modernization to provide higher quality, lower cost and advanced services, the gap between public and private offerings will widen, sophisticated users will shift increasingly to private networks and the remaining users

will find it difficult to secure basic and enhanced services at reasonable rates.... The ultimate impact of inadequate public telecommunications capacity on local economic and social conditions remains to be seen, but it could place selected regions and segments of society at a distinct disadvantage."

Company witness Selander stated that educational needs alone technically would justify the proposed enhancements, but when combined with government and research needs, the modernization project is even more economically feasible. The enhancements in the digital infrastructure would allow the system to carry a wider variety and greater quantity of traffic more economically. According to the Company, its new capabilities would include distance learning, a higher education library network, and a research network connecting universities, colleges and businesses to a centrally-located super computer. Utah State University's ComNet and the state government's digital communications requirements could be met. The Company testified that the increase in telecommunications services would promote economic development in general and rural development in particular.

A number of public witnesses testified in favor of fiber optic extensions to colleges, universities and high schools in support of distance learning. Mr. Steven Hess, Director of the Utah Educational Network, testified that it was his organization's goal to extend its distance learning service to every rural high school and applied technology center in need of the service, within the next five years. He further testified that the extension of fiber to those facilities would provide the capacity needed for such expansion. Dr. Bartell C. Jensen, Vice President for Research at Utah State University (USU)

and Dr. Glenn R. Wilde, Executive Director of the Merrill Library and Electronic Distance Education at USU, testified that the communications network proposed by U S WEST would provide the capabilities of two-way interactive video at community sites, schools and colleges and universities in the state. They further testified that the proposed U S WEST network would provide a critical and needed backbone service to make a statewide educational and training system workable. Mr. Will Gardner of BYU, and Chairman of UTAHNET, a Task force chartered by the Utah State Advisory Council for Science and Technology to study the needs for high capacity telecommunications in Utah, testified that upgrading the telecommunications infrastructure to reach schools (especially in the rural areas) with interactive television capabilities would be the single most effective way to upgrade the educational posture of the entire state.

In addition, the Commission has received many letters from educators, community leaders and concerned citizens in support of the modernization proposal.

The Company, the Division and the Committee offered testimony that the proposed central office upgrades would make enhanced services and capabilities available to all USWC's customers, including rural customers presently unable to obtain such services as equal access to interexchange carriers and such custom calling features as call waiting, call forwarding, speed calling, and 3-way calling. In addition, the upgrades will provide for more accurate and clearer transmission of voice and data. Further, the upgrade will allow the offering of additional CLASS services when the Company begins to market them in the state.

The Commission finds that the central office upgrades will provide more accurate processing of dialed digits, faster touch tone services, faster call completion, clearer conversations and more accurate data transmissions. The Commission further finds that the modernization plan will enable USWC to provide new services that are not currently available in Utah. In addition, the Commission finds that the proposed investments would be of benefit to and would meet a wide variety of residential, business, educational, governmental and research needs, and concludes that the Company's proposed modernization program is clearly in the public interest.

D. RISKS OF MODERNIZATION

The Company maintained that the proposed investments contained in its modernization plan, and in particular the investments in upgrading central offices, were discretionary and would not be made in a business-as-usual environment. These investments, although yielding benefits to the state and its citizens, might get subordinated to other investment opportunities. The Company maintained that modernization investments, while providing net benefits, are riskier in that the expected earnings received by USWC are less than the expected earnings on other possible investments. The Company claimed that only the opportunity to earn higher profits through a change in regulatory form would induce it to carry the additional risks of modernization investments. USWC maintained that the modernization plan is a good faith effort to demonstrate its intent to further its investment in Utah. The Company believes that by making investments that have high social benefits but low internal

rates of return to the Company, it demonstrates its commitment to the public interest.

The Company also argued that discretionary modernization investments can be risky in that they may not be incorporated into rate base. If the regulatory body determines that an investment is not prudent, then the shareholder must bear its cost. The Division pointed out that in the recent past there has not been a case where a major USWC investment had been excluded from rate base and, therefore, the risk to the Company is minimal. It contended that an understanding of this Commission's regulatory treatment of the Company's past investments is necessary to any analysis of the regulatory risk of a particular future investment.

The Company asserts that it may turn out that the demand for high capacity transmission is limited at present causing the revenues generated to be insufficient to fully cover costs. But the testimony of the other major parties was to the effect that if the investment is included in rate base, rates will be set to recover the costs, and thus the Company will be protected.

Both the Division and the Committee testified that most of the central offices included in the modernization plan are scheduled to be replaced by 1996 in the Company's business-as-usual budget. Thus, the plan would accelerate already planned investment by just a few years.

The Commission finds there is substantial evidence on the record that the modernization investments will benefit Utah in the near and long term future and are, therefore, a prudent risk for ratepayers.

There was considerable testimony on the record by the Division and the Committee asserting that depreciation policies adopted by the Commission have provided the Company the opportunity for rapid recovery of investment. The Company therefore has the ability to respond to rapid changes in technological innovation and emerging new, specialized customer demands without undue rate shocks to the general body of ratepayers. The Commission finds that the Commission has protected the Company's recovery of investment by adopting liberal depreciation policies.

Company witness Dr. William H. Davidson warned the Commission that it should not prescribe by order additional investment in the state of Utah. Any such effort could be circumvented by a reduction of investment elsewhere in the state. This could degenerate, he argued, into a situation where the Commission is forced to micro-manage the Company and thus assume responsibility for the investment decisions of the Company. The Commission ought not to have any desire for such a role. According to Dr. Davidson, the principal way to increase investment in Utah is to increase the rate of return on investments. He testified that the incentive plan is the most efficient way to raise the rate of return.

The Commission admonishes the Company against compensatory decreases in investment in other areas. There is evidence on the record of the Company's planned investment for the state absent an incentive plan. The Commission does not wish to see any gross deviations from those plans. USWC's investments in the state must insure a high quality of service as determined by this Commission. Appropriate regulatory measures will be taken to insure such quality of service. USWC possesses a certificate of convenience and

necessity and franchises to provide essential public services throughout its service territory. The Commission finds that the Company has the obligation to provide such services, determined by this Commission, so long as it holds that authority.

The Company also contended that its modernization plan in conjunction with the incentive plan increases its risk exposure. Such risk raises shareholders' required rate of return and therefore should be reflected in the incentive plan. Thus, the Company argued in favor of a gap between the authorized rate of return and that above which a sharing of earnings with ratepayers would commence. The Company maintained that it is at risk if the cost of capital increases. The Commission finds that such risk is attendant to the incentive plan alone and should not affect any decision on modernization. The Commission finds that neither the Company nor the ratepayer bears inordinate risk in modernizing the remaining electro-mechanical central offices, extending its digital "backbone" infrastructure, or the fiber optic extensions as contemplated by the Company's proposed modernization plan.

E. COMMISSION AUTHORITY

The Company has persuasively argued that the benefits of rural upgrade and modernization are substantial and those benefits are detailed herein and throughout this record. All parties are agreed that the public interest would be served by the modernization program proposed by the Company. At issue is the Company's insistence that the program is uneconomical without a change in regulatory framework as it has proposed in its incentive plan and that the Commission is

without authority to order modernization unless the Commission finds that the upgrades will be economical.

As clearly stated above, we do not agree that we must make such a finding. Nonetheless, we are of the view that the program may on the whole be economical. The Company submitted three studies on the economics of modernizing the central offices using its Capital Utilization Criteria (CUCRIT) model. The first study was submitted in response to the Committee's interrogatories concerning modernization. This response used data from a 1988 study on the then 54 remaining electro-mechanical central offices in the state. The study narrowed its analysis to the originally proposed 46 offices and concluded that modernization of these offices as a whole was uneconomic. However, as pointed out in the Committee's testimony, the study excluded the additional revenues that would be generated by the new services available from the upgraded offices. The Company updated this study by including these additional revenues and excluding five central offices that had reached "hard triggers". This study indicated that three of the central office upgrades were economical, 19 were marginally economical and 19 were uneconomical. Taken as a complete package, the investment was deemed by the Company to be marginally economical.

Mr. Fuehr ordered a new CUCRIT study in December of 1990 and late-filed with the Commission on February 13, 1991. This study examined the economics of the 41 central offices that were included in the revised modernization plan. It concluded that such modernization was uneconomic. Because this study was late filed, however, the parties could not adequately assess it. Therefore, the Commission cannot rely on it to make a finding. In addition, there

is no formal analysis on the record concerning the economics of the fiber optic backbone and central office interties.

In sum, the evidence purporting to show the Commission that the modernization program is uneconomical is not persuasive. The Commission finds that the Company's studies are not conclusive and may not include all of the benefits identified on the record, and therefore the Commission cannot conclude that the proposed central office modernization is uneconomical.

The Company cites two cases, the Mulcahy case (Mulcahy v. PSC, 117 P.2d 298, 1941) and the Lifeline case (Mountain States Telephone v. PSC, 1988) in support of its position that the Commission cannot order the Company to make expenditures which are uneconomical. Neither of those cases is convincing. The Mulcahy case is a trucking case in which the Commission was required to determine whether or not to grant a trucking company an operating certificate over opposition from an already certificated carrier for the same territory. In dictum the Court discusses the criteria for determining whether public convenience dictates that a new carrier be certificated in the territory and refers to the need to have the patronage for the service to justify the expense of rendering the service. That fact situation is completely different from the one facing the Commission here. In this case the Commission is considering the advisability of having a regulated utility upgrade its service. There is no debating whether or not another phone company should be granted a certificate in USWC's existing service territory. Clearly, the criteria for the entry of a competitor into an existing utility's service territory would be different and more stringent than the criteria for requiring an existing utility to upgrade its service. It is not unreasonable

in the Mulgahy case, as opposed to this one, that the Court should require that the would-be competitor's rates be cost-justified so as not to be predatory.

The Lifeline case stands for the proposition that the Commission lacks a specific delegation of legislative authority to have the customers of one utility in this state bear some of the cost of a program for the customers of another utility in this state.

This present case is not dealing with separate utilities--it is dealing only with USWC. The issue is whether or not the Company should be required to provide upgraded service for its own customers, not the customers of another utility. In the Lifeline case the Court determined that the Commission lacked a legislative delegation of authority to direct the Company to surcharge its customers for a statewide pool of Lifeline program funds that would be used for the customers of all phone companies. That has nothing to do with the Commission's authority to order an upgrade in the utility service offered by a utility to its customers. These are apple and orange issues.

There are multiple statutory references to the Commission's authority to require adequate service which supplement the Commission's general jurisdictional grant at 54-4-1:

The commission is hereby vested with power and jurisdiction to supervise and regulate every public utility in this state, and to supervise all of the business of every such public utility in this state, and to do all things, whether herein specifically designated or in addition thereto, which are necessary or convenient in the exercise of such power and jurisdiction.

The first of these is 54-4-7, which is a clear and plain statement of the Commission's authority to regulate and supervise the

services and commodities provided by utilities and order changes where present services are no longer adequate.

Whenever the commission shall find, after a hearing, that the rules, regulations, practices, equipment, appliances, facilities, or service of any public utility, or the methods of manufacture, distribution, transmission, storage or supply employed by it, are unjust, unreasonable, unsafe, improper, inadequate or insufficient, the commission shall determine the just, reasonable, safe, proper, adequate or sufficient rules, regulations, practices, equipment, appliances, facilities, service or methods to be observed, furnished, constructed, enforced or employed, and shall fix the same by its order, rule or regulation.

Section 54-4-8 is in the same vein.

Whenever the commission shall find that additions, extensions, repairs or improvements to or changes in the existing plant, equipment, apparatus, facilities or other physical property of any public utility or of any two or more public utilities ought reasonably to be made, or that a new structure or structures ought to be erected to promote the security or convenience of its employees or the public or in any way to secure adequate service or facilities, the commission shall make and serve an order directing that such additions, extensions, repairs, improvements or changes be made or such structure or structures be erected in the manner and within the time specified in said order.

Section 54-3b-11 charges the Commission with making available to customers throughout the state high-quality, universal telecommunications services. Section 54-3-1 requires that utilities provide equipment and service which promotes the safety, health, comfort and convenience of its customers.

The adequacy and convenience of service and equipment can change over time. Operator-switched calls and multi-party lines were once considered adequate; obviously, they no longer are. The Company itself has admitted on this record that the simple ability to complete a call in today's environment does not constitute adequate service. The Commission finds that service to certain customer areas

is not adequate by present day standards and that the modernization program is necessary at this time to provide all customers in this state with adequate and convenient service. It is, therefore, in the public interest. We conclude that it is for this Commission to determine what is necessary and convenient in the way of utility services, require the utility to provide it and allow that provider an opportunity to earn a fair return on its investment.

F. SUMMARY

The Commission recognizes that telecommunications provides beneficial externalities. A modern telecommunications infrastructure permits the efficient and economical flow of information, to the benefit of consumers of all sorts. As a result, it also may promote economic development.

Prudent and properly timed modernization is an important requirement facing the telecommunications industry. Therefore, it is a necessary element of good regulatory policy to promote economic and timely modernization. This Commission will encourage timely, socially beneficial investments, and will allocate corresponding costs fairly and equitably.

The Commission has found that the public interest requires the Company to undertake its modernization plan, whether or not its proposed incentive plan is approved. USWC will have the opportunity to earn its allowed rate of return on the proposed modernization investments and, therefore, will be compensated for the risk of such investment.

The Company must not provide discretionary modernization investment at the expense of investments otherwise undertaken to

maintain high quality service for the general body of ratepayers, however. The Company's investments in the state must insure high quality service, as determined by this Commission. Appropriate regulatory measures will be taken to insure that this occurs.

The Commission finds that existing services are no longer adequate and concludes that the modernization plan is justified in that it brings telecommunications in Utah in line with present day service expectations. Therefore, it is appropriate to order the Company to provide central office upgrades estimated to cost \$36.35 million and fiber-optic extensions so that the fiber optic infrastructure extends from Logan to St. George, with digital microwave extensions to Vernal and Price, at an estimated cost of \$21.5 million. These figures are represented by the Company to be the costs associated with these modernization investments. The Commission is ordering the modernization of the network, not the Company's estimated costs. The investments will be subject to the normal prudence reviews in future rate cases. As previously noted, the Commission, in the past, has not found the Company's investments to be unreasonable or excluded them from rate base.

The Division and the Company supported the proposed extension of fiber to colleges, universities and high schools only where deemed to be economically justified. As noted above, originally the Company proposed that the estimated \$33.88 million to extend fiber to such institutions would be a part of the overall modernization plan. The Commission is satisfied by the testimony on the record, including that of the public witnesses, as to the benefits of such extension. The Commission finds that fiber to the colleges, universities and high schools in the Company's territory is in the public interest and

ought not be purely discretionary. The Commission further finds that the Company must work with the Division and the various interested educational interests in the state to devise a program entailing the investment for extending fiber to these institutions as part of the total modernization plan. Such plan shall include details of the rates to be charged education for use of the network. Institutions should be required to sign contracts, or otherwise demonstrate that they will utilize the fiber optic service and pay the rates determined, before construction is authorized. Such plan shall be submitted to the Commission within three months of this Order. The Commission further finds that all modernization investments must be completed within 54 months of the Order, and booked as completed.

V. INCENTIVE REGULATION PROPOSALS

In this proceeding, both USWC and the Division made proposals for the adoption of so-called "Incentive Regulation" plans in this jurisdiction. In essence, incentive regulation is based upon the assumption that traditional regulation does not provide sufficient incentives for regulated utilities to operate as efficiently as possible. Incentive regulation allows the utility to earn in excess of the authorized rate of return on equity with the hope that such overearnings will provide a greater incentive to management and employees to undertake additional efficiencies.

A. DISCUSSION OF PLANS

1. USWC PLAN:

The term of USWC's plan is four years, commencing January 1, 1991 and terminating December 31, 1994. During the term of the plan,

no increases in basic rates would be permitted except as a result of changes in four "pass-through" categories: Commission-approved accounting changes required or allowed by Generally Accepted Accounting Principles (GAAP), changes in federal tax rates, FCC-mandated separations changes and Commission ordered changes in depreciation rates. Other rates would also be frozen, except for limited, revenue neutral adjustments approved by the Commission. Services that have been Commission approved as rate flexible or detariffed could be changed without Commission approval. USWC would be precluded from filing a rate case except where a full calendar year's earnings were lower than a 10.5 percent return on equity. The Company would be allowed to retain all earnings up to a 14.0 percent rate of return on equity. All earnings above 14.0 percent would be shared with customers on a 50-50 basis by annual credits on customer bills in the year following that in which overearnings occurred.

2. DPU PLAN:

The Division's proposed plan differs from the USWC proposal in several respects. The Division wants the sharing point to begin at the same level as the authorized return on equity ordered by the Commission in this proceeding, instead of the 14.0 percent level. Under the Division proposal, no pass-through rate adjustments are allowed. Instead of a firm, four-year term for the incentive regulation plan, without regulatory review, the Division proposes a five-year plan with a mid-point review and the option of an early termination of the plan if it is found to not be in the public interest. The Division's plan proposes a procedure for indexing the authorized return on equity in order to minimize the risk to the

Company of fluctuating capital costs during the term of the plan. The remaining differences are minor.

B. POSITIONS OF THE PARTIES

1. US WEST COMMUNICATIONS

In its testimony in support of its plan, USWC attempted to establish the weaknesses in traditional regulation which would justify the adoption of a significant departure from the current regulatory method. The perceived weaknesses can be grouped and summarized as follows:

a. Traditional regulation does not provide sufficient incentives for efficient managerial and employee performance. Under traditional regulation, management and employees do not share in the rewards of increased efficiency since the resulting overearnings are returned to ratepayers after a brief period of regulatory lag. Evidence cited in support of this position is as follows:

(1) Common Sense - It is intuitively obvious that greater financial rewards would motivate management and employees to increase their efficiency and upgrade their performance.

(2) Traditional - Traditional regulation is essentially a "cost-plus" arrangement between the utility and regulators, therefore, absent regulatory lag, overearnings resulting from efficiency gains are passed on to ratepayers rather than used to reward management or employees for improvements in efficiencies.

(3) Regulatory Lag - Regulatory lag is an insufficient incentive to undertake incremental increases in efficiency.

b. Traditional regulation retards the rate of technological innovation, delaying both the adoption of new technologies and the

introduction of new services. This is because incremental earnings derived from such new technologies or services ultimately inure to the benefit of ratepayers and not the shareholders. Furthermore, new efficiencies derived from technological advances are also lost to the shareholders, thus providing a disincentive to their introduction. The evidence cited by the Company in support of this argument is as follows:

(1) Common Sense - it is again intuitively obvious that the loss of additional revenues from new offerings and new efficiencies does not provide incentives to the Company to introduce them.

(2) Earnings/Risks - The opportunity for additional earnings will compensate the Company for the additional risks that flow from introducing new and untested technological changes and products.

c. Traditional regulation has an anti-investment bias. Since the Company is not able to earn a sufficiently high return on investment, it fails to invest in the basic infrastructure. The evidence provided here is to the effect that if the Company had a choice as to where to make "discretionary" investments, it would surely make those investments in activities and jurisdictions where the return was greater.

In addition to the criticism of traditional regulation summarized above, USWC asserted that incentive regulation would have the positive benefits that would accrue from reversing the negatives of traditional regulation. There would be greater efficiency, more rapid deployment of new technologies and services, and added investment in this jurisdiction. Additionally, the Company argued that incentive regulation protects customers from undue rate

increases during the term of the incentive regulation plan, because of the freeze on rate increases.

USWC did not agree with major provisions of the Division's incentive plan, specifically, the absence of a gap between the authorized rate of return on equity and the sharing point, the floating rate of return on equity, the absence of pass-throughs, and the term of the plan.

2. DIVISION OF PUBLIC UTILITIES

To one degree or another, the Division agreed with many of the justifications for incentive regulation put forth by the Company. Specifically, Division witnesses asserted that there is always room for improvement and additional efficiencies in the management processes. In addition, the Division contended that potential benefits might include additional sharable earnings to the ratepayers from the annual credit procedure, instead of all of those earnings above the authorized rate of return being lost by the ratepayers through regulatory lag. Potential benefits might also include the acceleration of new technologies and services, and regulatory costs might be reduced as a result of incentive regulation.

The Division argued, however, that there is no way to substantiate the likelihood of such benefits. Division witnesses characterized their proposal as an experiment - one designed to protect ratepayers from harm, and perhaps even benefit them, while allowing the Company to prove the benefits of incentive regulation.

The Division, however, disputed certain portions of the Company's plan, specifically, the gap between the authorized rate of return on equity and the 14 percent sharing level, which the Division

characterized as a Company windfall. In addition, the Division criticized the pass-through provisions because they allow single-item rate cases which are prohibited under Utah law. The absence of a mid-plan review with the option of termination if it is not resulting in benefits to the ratepayers is also a problem the Division identified.

3. COMMITTEE OF CONSUMER SERVICES

The Committee proposed elements of an incentive plan of its own, pursuant to a request by the Commission. However, the bulk of its testimony was in opposition to the plans of both the Company and the Division. The Committee's arguments in opposition to the implementation of an incentive plan are summarized as follows:

a. The Committee argued that prior to approving an incentive regulation plan, Utah law requires a finding by the Commission that rates under an incentive regulation plan would be "just and reasonable," which they interpret to mean equal to or less than rates under traditional regulation. The Committee contended that the evidence clearly shows that rates under incentive regulation would be higher than under traditional regulation, therefore the Commission cannot approve any incentive regulation plan.

b. The Company plan violates Utah law because it limits the right of the Division, the Committee or any other party from filing a rate case or order to show cause during the pendency of the plan.

c. The provision calling for pass-throughs under the Company plan is in violation of Utah law inasmuch as it would allow for single item rate cases.

d. The Division's mechanism for a floating rate of return on equity may also be a prohibited single-item rate case.

e. There is insufficient evidence to justify even the Division's "test" of an incentive regulation scheme.

f. Incentive regulation may create a disincentive on the part of the Company to invest in the basic telecommunication's infrastructure because it could earn a higher return on depreciated plant than on new plant.

g. The proposed rate freeze would block potential, future rate decreases

h. Employees and management have sufficient incentives under existing regulation since their pay is based on comparable industry standards and includes bonus and profit-sharing plans funded at ratepayer expense.

4. MCI

MCI argued that the Commission should not approve the incentive regulation plans of either the Company or the Division. However, if the Commission were to adopt the changes to the plans proposed by MCI witness Dr. Cornell, specifically, changes dealing with pass-throughs, the starting point of sharing, the sharing method and a ceiling, MCI would not oppose the plan. With respect to earnings sharing, Dr. Cornell recommended an increasing percentage for the Company as earnings grow to ensure that the Company is not rewarded for the easy efficiencies that already should have been implemented.

5. CONTEL

Contel argued in favor of the theory of incentive regulation, but did not address in detail the specifics of the USWC or the Division plans. It encouraged the Commission to adopt a plan that is, "A balanced plan, reasonably monitored to protect against the adverse effects of possible mistake (by the utility or the regulator)..." in the belief that such a plan, "...can bring results beneficial to the customer, the investor, and the public." It further argued that any finding for or against an incentive plan in this docket ought not to dictate the application of incentive regulation to other utilities.

C. DISCUSSION AND FINDINGS

We are being asked to make a significant departure from the current scheme of regulation in the state of Utah. As noted by Committee witness Dunkel, traditional regulation is performing relatively well in this jurisdiction. Ratepayers have received a series of rate reductions over the past four years, the Company continues to earn in excess of its authorized rate of return and the telephone network appears to have met the basic needs of its customers. In addition, telephone subscribership in the state is at an all time high level (96.5 percent as of March, 1990) and is well above the national average of 93.3 percent. No one argues that the system is perfect, but concrete evidence that it is failing in any major respect is absent from this record. On the other hand, the record in this case shows that the promised benefits of the incentive regulation proposals before the Commission are speculative and the possibility exists that unless a specific incentive regulation plan

is carefully crafted, there is risk of harm to the ratepayers. That could occur in the form of higher rates than ratepayers would have otherwise paid, or a windfall to shareholders in the form of higher earnings than their investment risk would otherwise justify, as will be discussed in more detail later. In light of this, the Commission must approach the abandonment of traditional regulation and current methods of balancing ratepayer and shareholder interests very carefully. Accordingly, the Commission finds that there must be evidence that a specific incentive regulation plan will be of benefit to ratepayers and in the public interest before the Commission will adopt such plan.

A review of the record shows that neither the Company nor the Division plans, as currently constituted, fully meets this standard. The evidence on the record does not substantially corroborate the assertions made by proponents of incentive regulation either in their attacks on traditional regulation or in support of the benefits of incentive regulation:

1. Assertion that traditional regulation does not provide sufficient incentives for efficient performance and that the proposed incentive plans will result in increased efficiencies. Under Utah law, public utilities have the clear responsibility to provide service that is "...efficient, just and reasonable." U.C.A. Sec. 54-3-1. It is therefore the obligation of the utility, in effect a condition of its right to operate as a public utility, to be efficient. Inefficiency, and particularly knowing inefficiency, would result in unjust and unreasonable charges for the utility's services which UCA 54-3-1 prohibits and deems unlawful. It is highly questionable whether it should be necessary to reward shareholders

with additional earnings in order to encourage the utility to be efficient.

The Company stated in this docket that USWC is an efficient operation, current service is adequate, and that it is more efficient today than it was five years ago. In addition, it testified that its Utah operations compare favorably with those of the other states it serves. This is due to a number of factors, including technological advances, existing incentive and bonus plans for management, and employee access to a profit-sharing plan. The Company also testified that competition has driven it to become more efficient.

The proponents of incentive regulation were not able to produce concrete evidence that their incentive regulation plans would produce the results promised. The Company indicated that the employee compensation plans would not be modified in order to insure that the rank and file employees would be allowed to share in the earnings to be generated under the incentive plan.

They were not willing to guarantee that gains in efficiency would result from the adoption of an incentive plan.

The Company could not specifically identify areas in which efficiencies would result from their incentive regulation plan, nor could they identify examples from other jurisdictions that have adopted incentive regulation plans of efficiencies that resulted or positive impacts upon ratepayers from sharing of revenues. In fact, there was testimony on this record that at least one experiment (NYNEX) had produced just the opposite effect. The Company admitted that there does not exist any quantifiable measure of efficiency gains arising from incentive plans.

One of the major witnesses sponsored by the Company in this proceeding was Professor Davidson who spoke in favor of incentive regulation as a means of addressing the emergence of competition on the national and international scene. Yet other Company witnesses testified that the Company's incentive regulation plan was not designed to meet the concerns of competition.

The Company could not produce an analysis of the impacts upon the ratepayers of incentive regulation. Company witnesses testified that it is impossible to quantitatively demonstrate that rates under an incentive plan will be equal to or lower than rates under traditional regulation. There was, however, testimony by the Company that adoption of an incentive regulation plan would increase the cost of capital to the Company due to higher risks. In addition, Company witnesses testified that one of the advantages of incentive regulation is that it encourages "risk taking" by the Company but that ratepayers would be exposed to the risk of Company failure since investment made during the course of the incentive plan will be in rate base at the end of the plan.

Of all of the arguments put forth by the proponents of incentive regulation, the one with the most appeal is the one with no basis other than "intuition". If we make it possible for the Company to increase its earnings by becoming more efficient through a properly crafted incentive plan, including an assurance that the rates that we begin with are such that the Company will not enjoy a windfall, the promise of increased earnings is motivation enough that efficiencies will probably result. Another argument in favor of a carefully crafted plan is that the sharing of overearnings, the annual accounting of earnings, and the allowance of a return of their

share of the earnings in some manner in the subsequent year, permits the ratepayers to receive at least some benefit of overearnings. In the past several years of consistent overearnings by the Company, such overearnings have benefitted only the shareholders. There is also appeal in the argument of the Division that even though the promised benefits of incentive regulation are speculative, if the plan is crafted in such a way that the ratepayers are not harmed, then it might be in the ratepayers' interest to try the "experiment" for a few years in order to test the theory of incentive regulation.

The Commission finds that the record does not fully support the arguments by proponents of incentive regulation that the Company lacks incentives to be efficient under current regulation. It further finds that the record is deficient in evidence that the incentive regulation plans proposed in this proceeding will create the incentives for efficiency promised. There is also an absence of evidence to fully support the contention that ratepayers will benefit from the adoption of the Company's or the Division's proposed incentive regulation plans.

2. Assertion that traditional regulation retards the rate of technological innovation which will be corrected under an incentive regulation plan. This argument flies in the face of a long-established principle, that if the Company is allowed the opportunity to earn the allowed rate of return (market cost of capital) on its utility investment, and with rates linked to that investment in the form of rate base, the utility has an incentive to increase investment in order to increase the absolute level of its profits.

The Company offered no concrete evidence to counter this widely accepted view. The Company did not offer any example of investments

not made, technologies withheld from Utah because of a lack of incentive, or services not offered in Utah because the Company had no incentive to earn additional revenues.

The Company has asserted in a number of proceedings before this Commission, and in this proceeding, that it faces a serious threat from competition. It is hard to accept the theory that the Company would withhold introduction of new technologies or new services that would help it meet that competition simply because an incentive regulation plan did not exist in Utah. There is evidence, however, that USWC has invested considerable sums in recent years in introducing new technologies and improving the telecommunications infrastructure generally. In addition, it appears that the independent telephone companies that operate in the state have had the incentive under traditional regulation to modernize their systems to a major degree.

There is also evidence that liberal depreciation policies, such as those adopted by this Commission since 1985, have a more direct and substantial impact upon modernization decisions than would an incentive regulation plan.

Some Company witnesses argued that under traditional regulation the Company is put at risk in its modernization efforts by arguments that certain investments are not prudent, yet the Company offered no evidence that this Commission has ever declared any investment by the Company to be imprudent and thus not allowable in rate base.

The Commission therefore finds that there is insufficient evidence to justify the assertion that traditional regulation, as implemented in this jurisdiction, discourages modernization or the introduction of new technologies or services. Furthermore, the

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Commission does not find valid the evidence on this record which purports to substantiate the assertion that adoption of incentive regulation would lead to more rapid deployment of new services or technologies.

3. The argument that traditional regulation has an anti-investment bias. Much of the analysis set forth above under Section b also applies to this assertion. It appears that the essence of this argument is that the Company is discouraged from investing in activities and jurisdictions where the return is not as high as other jurisdictions or business opportunities. In fact, Company witnesses asserted on the record that all the Company is really after is a higher return on its investment. The Commission finds that a commitment by the Company to the provision of public service and an opportunity to earn the allowed rate of return equal to the market cost of capital, as determined by this Commission, provides an appropriate long-term basis upon which investment decisions should be made by the Company.

4. The specific elements of the Company plan rejected by the Division and the Committee.

a. The proposed gap between the authorized rate of return and the sharing level of 14 percent.

We believe that the evidence on the record shows that such a gap would result in a windfall to the Company at the expense of the ratepayers. The studies of Division witnesses Compton and Henningsen substantiate this conclusion. Testimony of MCI witness Cornell to the effect that such a gap would reward the Company for "easy efficiencies" is further evidence. The Commission therefore finds that the record does not justify the existence of a gap between the

rate of return authorized by the Commission in this proceeding and the point at which the ratepayers begin to share in the results of Company efficiencies.

b. The proposed pass-through items proposed in the Company plan. One of the more public assertions made by the Company both before the proceeding began (as established in the numerous letters received by the Commission in support of the proposed modernization and incentive plans, which letters were apparently generated in large part by the active lobbying of the Company) and during the course of the proceeding, was that rates would be frozen during the duration of the incentive regulation plan. Yet the Company has requested that rates be allowed to increase in the event the four designated pass-through items require it. The parties that argued against the inclusion of pass-throughs contended that by selecting items that would in all likelihood result in increases in rates, but excluding factors that would in all likelihood result in additional revenues to the Company is not fair to ratepayers. It was further argued that such pass-throughs are single-item rate cases which have been declared illegal in this jurisdiction. The Commission finds that the arguments against pass-throughs are persuasive and we will not allow them in any plan approved by the Commission.

c. The absence of a mid-term review of incentive regulation and the absence of a means of bringing an action before the Commission to consider termination of a plan.

The arguments are based in large part upon public policy, i.e., it is not wise to deprive the Commission and other regulators of a mechanism for reviewing in detail and in public this significant departure from the regulatory norm. There was also argument that

depriving regulators of this opportunity would be in violation of Title 54 of the Utah Code provisions which set out the duties of the Division and the Commission. We find that any restriction in an incentive regulation plan on the right of the Commission, the Division, the Committee or any other party to request a review of an approved plan would not be in the public interest. We do, however, note that in order for an incentive plan to succeed in the manner contemplated, that there must be a presumption that it will be allowed to proceed for a period of several years, absent a clear showing that it is not in the public interest.

Based upon the foregoing, the Commission cannot adopt the incentive plan of either the Company or the Division as presented to the Commission. We find that the adoption of such plans in their current forms would not result in the promised efficiencies or investments nor would they be of benefit to the ratepayers of this state.

This hearing is unique in the respect that we are proceeding pursuant to a statute that allows the Company to opt out of a plan approved by the Commission (54-4-4.1). We interpret this statute to give us some discretion in crafting an alternative plan that we believe would be in the public interest.

Based upon the record before us, and in conformance with the findings heretofore entered by this Commission, we approve an incentive regulation plan with the basic elements to be set forth hereafter. It is our intention that the Company and the other parties be given the opportunity to review these basic elements and engage in discussions concerning them. If the Company chooses to reject the plan as proposed, it may so notify the Commission pursuant

to the aforesaid statute. If it chooses to accept the plan as outlined, the Commission would order the parties to meet to draft the details of such a plan and to submit them to the Commission for its consideration and approval.

The Commission is approving the following plan based upon the arguments already stated above that proper monetary incentives may increase the efficiency of the Company, and as argued by the Division, that if carefully crafted to protect the interests of the ratepayers, an experiment in incentive regulation may be in the public interest. In addition, the Commission finds that the following plan will allow the ratepayers to benefit by receiving a share of overearnings of the Company that may result from the Company earning in excess of its authorized rate of return.

The Commission finds that an incentive regulation plan based upon the following general principles will protect the interests of ratepayers, could produce a more efficient operation by USWC, will allow a proper experiment in incentive regulation and is in the public interest:

1. Rates will be frozen except as modified pursuant to item 6 hereafter and subject to revenue neutral changes in rates ordered by the Commission as a result of contemplated cost-of-service monitoring on a regular basis.

2. Regulation of the Company will continue in all respects as with traditional regulation, except as modified by this Order.

3. The starting point for sharing between the ratepayers and shareholders shall be at the authorized rate of return on equity set by the Commission in this Order, 12.2 percent.

4. Earnings by the Company between 12.2 percent and 13.2 percent on equity will be shared 80 percent to the ratepayers and 20 percent to the shareholders.

Earnings between 13.2 percent and 14.2 percent shall be shared 60 percent to the ratepayers and 40 percent to the shareholders.

Earnings between 14.2 percent and 17 percent shall be shared 50 percent to the ratepayers and 50 percent to the shareholder.

Earnings in excess of 17 percent shall all be returned to the ratepayers.

5. There will be no pass-through adjustments.

6. The ratepayers' share of earnings in excess of 12.2 percent will be calculated as soon as possible in the next calendar year. Disposition of such share will be determined by the Commission, after hearing, in one or more of the following ways:

- a. one-time credits against the customers' bills;
- b. permanent rate reductions or restructuring;
- c. investment in the infrastructure in addition to that ordered herein.

7. The term of the plan is for five years. The Commission can terminate the plan at any time if it is convinced that the public interest justifies termination. At any time during the duration of the plan the Company can request a rate case. In addition, at any time the Division or the Committee can request the Commission to undertake an investigation of the rates and charges of the Company. However, the Company, the Division and the Committee will have to overcome the presumption that it is in the public interest that the plan be allowed to go the entire five-year experimental period.

8. The plan will include the service performance standards proposed by the Division in this proceeding. It is the Commission's intention, however, to conduct a comprehensive examination of quality of service and to assess the adequacy of these standards within six months following adoption of the incentive plan.

9. The Company will devise and implement a method of sharing a portion of the excess earnings earned under this plan with employees of the Company. Such plan will be filed with the Commission.

10. The Company will continue to file with the Commission monthly reports as to its earnings. In addition, the Company will file quarterly reports detailing efficiencies resulting from the plan.

11. The Company will file with the Commission, and the Division will evaluate, annual intrastate revenue requirement determination on both an actual and a prospective test-year basis.

12. The Division will file with the Commission the results of annual cost-of-service studies using the DCOS model. The cost-of-service studies are also to be on an actual and prospective test-year basis and to be consistent with the determination of revenue requirement. The cost-of-service studies shall be performed utilizing accounting information and special studies, such as access lines and minutes of use, from the same time period.

By design, the above sets out the minimal details concerning the Commission's ordered incentive plan. The Commission is convinced that the details of the plan can be worked out by the parties within a relatively short time period.

ORDER

NOW, THEREFORE, IT IS HEREBY ORDERED that:

1. USWC reduce its revenues by \$19,799,000 in accordance with the spread and rate design portions of this Order.

2. USWC incorporate the revenue reduction into its rates and schedules in conformance with Attachment A hereto and file appropriate revised tariffs with the Commission, which tariffs shall take effect on July 1, 1991.

3. USWC implement the central office modernization and fiber-optic extensions described and set forth in this Order and devise a program in consultation with the Division and potentially affected educational institutions for fiber-optic extensions to those institutions. The details of this program are to be reported to the Commission within three months of this Order. The modernization and extensions shall be completed within 54 months of the Order.

4. USWC file notice with the Commission as soon as possible, but not later than 60 days following the date of this Order, of its acceptance or rejection of the incentive plan detailed herein.

5. USWC undertake and report the following projects:

a. Develop a stimulation model for toll, 800, outWATS and switched access services within one year of the date of this Order.

b. Track the growth and minutes of usage for the services listed in paragraph (a) and report them quarterly beginning October 1, 1991.

c. Provide the Division with 1990 SLUS information and such other information as is necessary to enable the Division to prepare a DCOS study based on 1990 actual results of operations consistent with Commission findings in this case by July 15, 1991.

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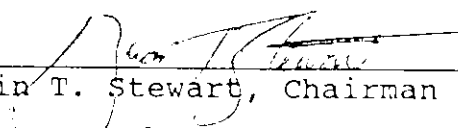
d. Provide, in conjunction with the Division, additional information on separate identification and allocation of NTS costs for local switching equipment.


6. The Division perform and report the results of the 1990 DCOS study to the Commission and make it available to the Committee and other interested parties.

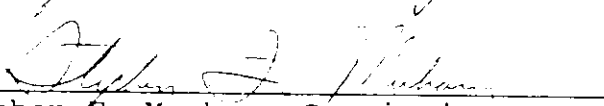
7. To the extent the Commission has inadvertently omitted from the ordering provisions of this Order any duty or obligation intended to be imposed upon USWC or the Division, which duty or obligation is otherwise clear from the language of preceding portions of this Order, it is hereby incorporated herein by this reference and made a part hereof.

8. Within 30 days of the issuance of this Order, an aggrieved party may file a written request for review by the Commission. If such request is denied in writing within 20 days or deemed denied by Commission inaction after 20 days, the aggrieved party then has 30 days following such denial within which to petition the Supreme Court for review.


DATED in Salt Lake City, Utah this 19th day of June, 1991.


Brian T. Stewart, Chairman


James M. Byrne, Commissioner


Stephen F. Mecham, Commissioner

ATTEST:


Stephen C. Hewlett
Commission Secretary

ADDENDUM C

U S WEST COMMUNICATIONS, INC.

EXHIBIT NO. 10R.4

APPROVED EARNINGS SHARING PLANS

STATE (A)	FLOOR ROE (%) (B)	AUTHORIZED ROE (C)	TRIGGER ROE (%) ¹ (D)	ROE TRIGGER GAP (%) (D-C)	BANDWIDTH SPREAD (%) (D-B)
ALABAMA	13.42	13.87	14.50	0.63	1.08
CALIFORNIA	7.58	13.00	15.50	2.50	7.92
CONNECTICUT	11.00	13.00	13.50	0.50	2.50
FLORIDA	11.50	13.20	14.00	0.80	2.50
GEORGIA	12.00	13.00	14.00	1.00	2.00
KENTUCKY	11.68	13.05	14.15	1.10	2.47
MARYLAND ²	(3)	13.60	13.60	0	N/A
MICHIGAN	12.25	13.25	13.25	0	1.00
MINNESOTA	10.00	12.15 ⁴	13.50	1.35	3.50
MISSISSIPPI	12.03	13.26	13.67	0.41	1.64
MISSOURI	11.61	12.61	14.10	1.49	2.49
NEW MEXICO ⁵	(3)	13.75	13.75	0	N/A
RHODE ISLAND ⁶	(3)	13.25	13.25	0	N/A
TENNESSEE ⁷	12.50	13.40	14.40	1.00	1.90
TEXAS	11.44	12.85 ⁴	14.20	1.35	2.76
WASHINGTON ²	10.42	12.83 ⁴	13.72	0.89	3.30
AVERAGE	11.34	13.13 ⁸	13.94	0.81 ⁹	2.70

¹ ROE at which sharing begins.

² Maryland and Washington have hypothetical capital structures. Washington's trigger point based on an actual capital structure is 13.15. Maryland's information is unavailable.

³ No floor specified.

⁴ Derived based on settlement. No actual authorized ROE determined.

⁵ Company may file for rate relief when determined that substantial damage to earnings has occurred.

⁶ Company prohibited from filing rate case.

⁷ If company drops below the ROE floor, company only recovers 40-60% of the difference between actual earnings and the floor.

⁸ Average ROE of those states without a gap is 13.45. (Maryland, Michigan, New Mexico and Rhode Island)

⁹ The Nevada plan has not yet been implemented by any company. Company may opt to stay under traditional regulation. If no gap is considered for Nevada, the average trigger gap is .77.

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DATE 3-11-91
TIME 9:04 AM
BY WILLIAMS
BOSTON NSWC 10R.4

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