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Judicial Review of Utility Ratemaking in Minnesota: An Analysis and a Proposal

Neil Hamilton
Irving Colacci

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Regulation of public utilities has become a controversial and troublesome issue. In the past decade, numerous events have profoundly affected regulation in general and regulation of public utilities in particular. The energy crisis precipitated by the Arab oil embargo, the increased interest in environmental questions, the Three Mile Island accident, high inflation rates, and the growing pressure for deregulation of selected industries are examples of recent influences on governmental regulation. As costs continue to...
rise, the rates public utilities are allowed to charge customers are of increasing concern to business and the general public.

Public concern over utility rates heightens the responsibility of courts to review decisions of regulatory agencies in a meaningful manner. Judicial review of utility commission rate determinations is currently an issue of interest in Minnesota due to a recent case decided by the Minnesota Supreme Court. In 

Hibbing Taconite Co. v. Public Service Commission,

the court articulated a standard of review applicable to rate determinations. Specifically distinguishing between rate of return and rate allocation determinations made by the commission, the standard subjects each type of determination to a different standard of review. The court’s approach is unhelpful and places the commission in an unreasonable and confusing position. The classification does not account for the inherent difficulties involved in assigning precise values to all rate of return factors, and instead treats the entire rate of return determination as a factual determination and thus subject to a more stringent

morbid state of the economy. Inflation continues to outstrip any efforts to cope with it, rendering regulatory decisions obsolete practically at the moment of pronouncement.

Charles A. Fraas, Jr., Commissioner of the Missouri Public Service Commission (dissenting in Kansas City Power & Light Co., Case No. ER-80-48), reprinted in 

PUB. UTIL. FORT., Feb. 26, 1981, at 14; see also 2 A. KAHN, THE ECONOMICS OF REGULATION 123-26 (1971);

Hyman, Should Electric Utilities Be Deregulated?, 

PUB. UTIL. FORT., Aug. 14, 1980, at 43 (proposing that generation arm of electric industry be deregulated through use of contract bidding by non-regulated businesses); Stauffer & Navarro, A Critique of Conventional Utility Rate-making Methodologies, 


Attrition of utility companies’ earnings has been another major problem facing the utility industry. Factors causing attrition are numerous, “including a rapid increase in operating costs owing to inflation, rising capital costs because the high rate of inflation has led to senior capital costs rates greater than embedded costs, and substantially faster growth of utility plant than energy sales.” French, On the Attrition of Utility Earnings, 

PUB. UTIL. FORT., Feb. 26, 1981, at 19-20. In addition, revenue is limited through the regulatory process and companies themselves often do not seek rates high enough to cover increased costs. Id. French argues for adopting “a fully forecast test year” as one method to help offset the effects of high inflation. Id. at 23. Several states, including California, New York, and Minnesota, have used prospective test year procedures. Interim rate increases are also useful in combating the effects of excessive inflation. Id. at 24.

2. 302 N.W.2d 5 (Minn. 1980).

3. See id. at 9. The court stated:

[W]e now hold that the establishment of a rate of return involves a factual determination which the courts will review under the substantial evidence standard. When the PSC allocates rates among classes of customers, it acts in a legislative capacity and the courts will uphold the PSC's decision unless it exceeds the PSC's statutory authority or results in unjust, unreasonable, or discriminatory rates by clear and convincing evidence.

Id.
substantial evidence scope of review. This article evaluates the announced standard, compares it with approaches taken by federal courts, and proposes an alternative approach that would be more useful and meaningful to both the commission and the courts.

A second significant feature of the Hibbing Taconite decision is the court's rejection of a methodology employed by the commission since 1977 to analyze and resolve the rate of return issue. The court forbid the use of the North Central doctrine, notwithstanding the doctrine's consistency with statutory mandate and practical usefulness in resolving the difficult issues faced by the commission in rate of return determinations. This article explains the doctrine and its use by the commission and proposes that, with minor modifications, it be utilized by the commission in the future in such a way as to comply with the court's holding in Hibbing Taconite.

II. CONSTITUTIONAL REQUIREMENTS FOR RATE OF RETURN DETERMINATIONS

Any analysis of the rate of return issue must begin with the two United States Supreme Court decisions that established minimum constitutional requirements. The constitutional criteria focus on whether the rate of return is confiscatory and, as such, is an unconstitutional taking of property without just compensation. The Minnesota Supreme Court still relies on Bluefield Waterworks & Improvement Co. v. Public Service Commission and Federal Power Commission v. Hope Natural Gas Co. to determine whether rate of return determinations are constitutionally valid.


5. See infra notes 91-114 and accompanying text. The applicable statute defines the "reasonable rate" to be charged by a public utility. See Minn. Stat. § 216B.03 (1982).


7. 320 U.S. 591 (1944).


In Bluefield, the Court articulated the basic constitutional consideration, stating:

Rates which are not sufficient to yield a reasonable return on the value of the
In *Bluefield*, the Court recognized that investors in public utilities are entitled to a fair rate of return on their invested capital, commensurate with other similar businesses of comparable risk.\(^9\) In addition, the rate of return must maintain the financial integrity of the utility and allow it to attract new capital.\(^{10}\) The constraints put on the rate of return were the elimination of excessive profits and the assurance of efficient and economical management.\(^{11}\) *Hope* further elaborated on the minimum requirements of rate of return determinations. In *Hope*, the Court developed the "end result" doctrine. This doctrine directs that the emphasis of judicial review be on the effects and final determination of the commission's findings, rather than on the method employed to de-

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\(^9\) 262 U.S. at 692. The Court stated:

A public utility is entitled to such rates as will permit it to earn a return on the value of the property which it employs for the convenience of the public equal to that generally being made at the same time and in the same general part of the country on investments in other business undertakings which are attended by corresponding risks and uncertainties.

*Id.*

*Bluefield* had great influence in the development of the comparable earnings approach to setting the rate of return. Many commissions, however, have refused to adopt the comparable earnings methodology due to the difficulty of finding "comparable" companies. *See* New England Tel. & Tel. Co. v. Public Util. Comm'n, 390 A.2d 8 (Me. 1978). Applying the *Bluefield* comparable risk standard has proven to be difficult and elusive in practice.

It has been over fifty years since . . . [*Bluefield*] and yet there is no universally acceptable measure of risk available to the industry today. Risk is a very complex issue and is difficult to quantify. . . . There appears to be a consensus among the respondents that utilities have become riskier in the past decade. Problems such as regulatory lag, inadequate rate relief, and the related political and consumer pressures to keep rates low should be dealt with if utilities are to regain the confidence of investors and compete successfully for funds in the financial markets at reasonable rates.

Chandrasekaren & Dukes, *Risk Variables Affecting Rate of Return of Public Utilities*, PUB. UTIL. FORT., Feb. 26, 1981, at 32, 33-35 (authors used questionnaire survey to determine "the attitudes of investment bankers towards risk and return measurement").

\(^{10}\) 262 U.S. at 693. The financial integrity requirement deals with the problem of protecting the book value of stock in the utility. This requirement is of special interest today due to the precarious financial situation faced by many utility companies. The effects of inflation and the high cost of nuclear power plants have put the utilities in a very difficult situation. *See* Kamerschen & Paul, *Erosion and Attrition: A Public Utility's Dilemma*, PUB. UTIL. FORT., Dec. 21, 1978, at 21, 22-28; *see also* Navarro, supra note 1 (dealing with problem of "economic obsolescence" of current plants and need for continued investment in new construction to ease dependence on foreign oil despite cash flow problems and industry wide hesitation).

\(^{11}\) 262 U.S. at 692-93.
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termine the allowable percentage. The Court stated, "It is the result reached not the method employed which is controlling... It is not theory but the impact of the rate order which counts." Along with the "end result" doctrine, the Court reemphasized the Bluefield standards in evaluating the rate order determination.

The constitutional requirements articulated by the United States Supreme Court are necessarily general and do not impose strict standards on the methods employed to arrive at rate of return determinations. As long as the "end result" of the ratemaking process meets minimum legal requirements, the rate of return will pass constitutional muster.

III. THE HIBBING TACONITE STANDARD OF REVIEW

In Minnesota, the responsibility for regulating public utilities and setting maximum allowable rates lies with the Public Utilities Commission. The commission conducts extensive hearings and issues a report and order containing findings of fact and conclusions of law. The order is subject to judicial review and the commission's determinations must comport with statutory requirements. The scope of judicial review is a significant factor in the process of ratemaking.

Judicial review of state administrative agency determinations is

12. 320 U.S. at 602.
13. Id.
14. MINN. STAT. § 216B.02 (1982) provides:
   The commission is hereby vested with the powers, rights, functions, and jurisdiction to regulate in accordance with the provisions of laws 1974, Chapter 429 every public utility as defined herein. The exercise of such powers, rights, functions, and jurisdiction is prescribed as a duty of the commission. The commission is authorized to make rules and regulations in furtherance of the purpose of laws 1974, Chapter 429.
15. Rate cases are formal adjudicative proceedings. See MINN. STAT. §§ 14.02(3), ,57-.59, .62 (1982).
16. MINN. STAT. § 14.63 (1982) provides:
   Any person aggrieved by a final decision in a contested case is entitled to judicial review of the decision under the provisions of [this section], but nothing in [this section] shall be deemed to prevent resort to other means of review, redress, relief, or trial de novo provided by law now or hereafter enacted.
17. Section 216B.03 provides, "Every rate made, demanded, or received by any public utility ... shall be just and reasonable. Rates shall not be unreasonably preferential, unreasonably prejudicial or discriminatory, but shall be sufficient, equitable and consistent in application to a class of consumers." Cf. MINN. STAT. § 216B.16(6) (1982) (listing considerations to be weighed by commission with respect to funds derived from requested rate increase to be used for construction).
controlled by the state Administrative Procedure Act. The Act gives the court power to reverse, remand, modify, or affirm agency decisions on the basis of six criteria. The most troublesome standards are the substantial evidence standard and the arbitrary and capricious standard. The Minnesota Supreme Court's interpretation of the content of these two standards, as well as the appropriateness of their application to utility commission orders, has led to considerable confusion as to how much detail or evidence is required in order to uphold an agency's decision. This same tension between judicial presumptions and strict application of the substantial evidence test has led to similar problems in the federal courts.


19. The scope of judicial review is governed by MINN. STAT. § 14.69 (1982):

In a judicial review under sections 14.63 to 14.68, the court may affirm the decision of the agency or remand the case for further proceedings; or it may reverse or modify the decision if the substantial rights of the petitioners may have been prejudiced because the administrative finding, inferences, conclusion, or decisions are:

(c) Unsupported by substantial evidence in view of the entire record as submitted; or
(f) Arbitrary or capricious.

See generally Baird, supra note 18, at 309-10.

20. Generally, in Minnesota the substantial evidence test means such relevant evidence as a reasonable mind might accept as adequate to support a conclusion. Reserve Mining Co. v. Herbst, 256 N.W.2d 808, 825 (Minn. 1977); see Taylor v. Beltrami Elec. Coop., Inc., 319 N.W.2d 52, 56 (Minn. 1982); In re Plum Grove Lake, 297 N.W.2d 130, 135 (Minn. 1980); In re Pautz, 295 N.W.2d 635, 637 (Minn. 1980); cf. No Power Line, Inc. v. Minnesota Env’tl Quality Council, 262 N.W.2d 312, 325 (Minn. 1977) (decision by agency presumed correct and deference shown unless demonstrated that decisions were improperly reached and incorrect). This test applies to all quasi-judicial agency action. When the state agency is said to be acting in a legislative capacity, the agency action is reviewed only to determine whether it is in excess of statutory authority, unjust, unreasonable or discriminatory. See Minnesota Power & Light Co. v. Minnesota Pub. Serv. Comm’n, 310 N.W.2d 686, 692 (Minn. 1981); Hibbing Taconite Co. v. Minnesota Pub. Serv. Comm’n, 302 N.W.2d 5, 9 (Minn. 1980); St. Paul Area Chamber of Commerce v. Minnesota Pub. Serv. Comm’n, 312 Minn. 250, 262, 251 N.W.2d 350, 358 (1977). These last three terms appear to describe the “arbitrary and capricious” standard of review set forth in the statute. See MINN. STAT. § 14.69(f) (1982). See generally Beck, Administrative Contested Case Practice in Minnesota, 37 BENCH & B., Sept. 1980, at 39, 45-46.

21. The difficulty faced by the Minnesota Supreme Court in interpretation and ap-
It is clear, at least, that the Minnesota Supreme Court long ago abandoned an "any evidence" approach.\textsuperscript{22} The court must be furnished with enough evidence to be able to apply the appropriate standard of review and the agency must show that its conclusions are based on the evidence.\textsuperscript{23}

In \textit{Hibbing Taconite Co. v. Public Service Commission},\textsuperscript{24} the Minnesota Supreme Court addressed the proper scope of judicial review of utility commission ratemaking determinations. Minnesota Power & Light Company (MP&L) had applied for a rate increase. The company followed all statutory requirements.\textsuperscript{25} A hearing was held before a hearing examiner. The commission, in issuing its report and order, adopted some of the hearing examiner's conclusions, rejected others, and considered certain issues not considered by the hearing examiner. Hibbing Taconite Company, an intervenor in the rate case,\textsuperscript{26} as well as MP&L, appealed the commission's order to the district court. The district court affirmed the commission's rate allocation determination but remanded the rate of return on common equity determination to the commission. The Minnesota Supreme Court affirmed the district court's decision with modification.\textsuperscript{27}

The \textit{Hibbing} court stated that the proper standard of review for rate of return determinations is a substantial evidence standard.\textsuperscript{28} The proper standard for rate allocation determinations is different. Rate allocation determinations are legislative functions to be up-


\textsuperscript{23} See Bryan v. Community State Bank of Bloomington, 285 Minn. 226, 172 N.W.2d 771 (1969); cf. People for Envtl. Enlightenment & Responsibility (PEER), Inc. v. Minnesota Envtl. Quality Council, 266 N.W.2d 858, 871 (Minn. 1978) (reviewing court must decide whether findings of fact below are sufficiently specific to permit agency action).

\textsuperscript{24} 302 N.W.2d 5 (Minn. 1980).

\textsuperscript{25} Id. at 7-8.

\textsuperscript{26} Id. at 7.

\textsuperscript{27} Id. at 8. For a discussion of the court's application of the substantial evidence scope of review to the discounted cash flow methodology used by the commission, see infra notes 48-56 and accompanying text. The court's rejection of the \textit{North Central} doctrine is also discussed. See infra notes 91-115 and accompanying text.

\textsuperscript{28} Id. at 9.
held unless they result in "unjust, unreasonable, or discriminatory rates by clear and convincing evidence," or if the commission acts beyond its statutory authority. This bifurcated standard of review is not useful. Two main difficulties arise when the standards are applied to commission determinations. The first problem involves the separation of the ratemaking process into two classifications for the purpose of judicial review. While some sort of separation between various determinations of the commission is appropriate, the court's characterization of rate of return as a factual determination, and thus subject to stricter review, is not well founded. Secondly, the application in Hibbing of the more stringent substantial evidence standard to the rate of return determination was too strict and focused on the wrong factors. In order to fully understand the announced distinction, and the application of the substantial evidence standard, an analysis of past Minnesota Supreme Court decisions reviewing agency determinations in general, and utility commission determinations in particular, is necessary.

29. Id. This same bifurcation of the scope of review of ratemaking was implicitly reaffirmed in Minnesota Power & Light Co. v. Minnesota Pub. Serv. Comm'n, 310 N.W.2d 686 (Minn. 1981). Prior to Hibbing Taconite, the court had characterized the ratemaking process as essentially legislative, while providing that fact questions be subject to somewhat more scrutinizing review. See Arvig Tel. Co. v. Northwestern Bell Tel. Co., 270 N.W.2d 111, 116-17 (Minn. 1978) (public convenience question classified as legislative and likened to rate setting); Northwestern Bell Tel. Co. v. State, 253 N.W.2d 815, 820 (Minn. 1977) (lower court's restrictions on commission rate of return determination in process of remanding for further consideration held impermissible); Northwestern Bell Tel. Co. v. State, 299 Minn. 1, 27-28, 216 N.W.2d 841, 857 (1974) (court extends great deference to commission on rate of return determination due to difficulty of arriving at precise findings).

Other states have followed a similar approach. In Dayton Power & Light Co. v. Public Util. Comm'n, 61 Ohio St. 2d 215, 400 N.E.2d 396 (1980), the utility challenged the rate of return determination primarily on the basis that the commission relied on historical data to compute the growth rate. The utility also argued that a comparable earnings approach would result in a more reasonable rate of return figure. The Ohio court rejected the utility's arguments and applied a relatively lax standard of review, stating:

A finding and order by the Public Utilities Commission will not be disturbed unless it appears from the record that such finding and order are manifestly against the weight of the evidence and are so clearly unsupported by the record as to show misapprehension or mistake or willfull disregard of duty. Id. at 217, 400 N.E.2d at 398, quoting Columbus & S. Ohio Elec. Co. v. Public Util. Comm'n, 58 Ohio St. 2d 120, 388 N.E.2d 1378 (1979); see also In re Hawaii Elec. Light Co., 60 Hawaii 625, 594 P.2d 612 (1979) (commission's determination of rate of return upheld where utility failed to demonstrate that determination was clearly erroneous); Union Elec. Co. v. Illinois Commerce Comm'n, 64 Ill. App. 3d 700, 381 N.E.2d 1002 (1978) (commission rate of return determination upheld as not against manifest weight of evidence).
The Minnesota Supreme Court first distinguished between legislative and quasi-judicial functions of utility commission ratemaking determinations in *St. Paul Area Chamber of Commerce v. Minnesota Public Service Commission.*\(^{30}\) In *St. Paul Area*, the court reviewed a commission determination concerning allocation of rate increases granted to Northern States Power Company among various classes of customers.\(^{31}\) The commission had considered both cost of service evidence and other factors, such as, ability to pay, ability to "pass on," ability to "write off," and value of services.\(^{32}\) The St. Paul Area Chamber of Commerce and the Minneapolis Association of Building Owners and Managers appealed to district court, challenging the commission's rate schedule.\(^{33}\) The district court considered three issues, deciding that: (1) the state Administrative Procedure Act (APA) was applicable and required a "substantial evidence test"; (2) the rate structure failed to meet the "substantial evidence" test; and (3) it was proper for the court to fashion a valid rate structure by modifying the commission's determinations.\(^{34}\) The Minnesota Supreme Court reversed, holding that the APA "substantial evidence" standard was applicable only to quasi-judicial determinations by the commission.\(^{35}\) Further, the district court was to remand rate structure determinations rather than engage in judicial modifications.\(^{36}\)

The *St. Paul Area* decision distinguished between quasi-judicial functions and legislative functions in the ratemaking process and subjected the two functions to different standards of review.\(^{37}\) The court reasoned that the commission, when acting in a quasi-judicial capacity, is filling "a role similar to that of a trial judge sitting

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30. 312 Minn. 250, 251 N.W.2d 350 (1977).
31. *Id.* at 251-52, 251 N.W.2d at 352-53.
32. *Id.* at 252, 251 N.W.2d at 353.
33. *Id.* at 253, 251 N.W.2d at 353.
34. *Id.*
35. *Id.* at 259-61, 251 N.W.2d at 356-57.
36. *Id.* at 263, 251 N.W.2d at 358.
37. In *St. Paul Area*, the court stated:
   
   (a) When the Public Service Commission acts in a judicial capacity as a fact finder, receives evidence in order to make factual conclusions, and weighs that evidence as would a judge in a trial court, it will be held on review to the substantial evidence standard.
   
   (b) When the Public Service Commission acts in a legislative capacity, as in rate increase allocations, balancing both cost and noncost factors and making choices among public policy alternatives, its decisions will be upheld unless shown to be in excess of statutory authority or resulting in unjust, unreasonable, or discriminatory rates by clear and convincing evidence.

*Id.* at 262, 251 N.W.2d at 358.
without a jury. To determine whether the commission is acting in a quasi-judicial capacity the court focused on the procedures employed.

In cases where the commission acts primarily in a judicial capacity, that is, hearing the views of opposing sides presented in the form of written and oral testimony, examining the record, and making findings of fact, the administrative process is best served by allowing the district court to apply the substantial evidence standard on review.39

In contrast, the legislative function is characterized by the presence of a need to balance "public policies" and "private needs." Non-cost factors must be considered. Because policy considerations are involved, the court must accord great latitude to the commission's decision and presume the decision valid in order to avoid substituting the court's judgment for that of the commission.41

In *Hibbing Taconite*, the court further elaborated on the *St. Paul Area* standard of review distinction, stating specifically that rate of return determinations are quasi-judicial and rate allocation determinations are legislative.42 This distinction is overly broad. Gross generalities are not helpful in dealing with the complex issues involved in the ratemaking process. Application of the *Hibbing Taconite* distinction to commission ratemaking determinations subjects the commission to too little review as to rate allocation issues and too strict a review as to rate of return issues. An analysis of the rate of return issue will illustrate the shortcomings of the court's overbroad distinction between rate allocation and rate of return determinations.

In *Hibbing Taconite*, the court remanded the rate of return determination, holding that the commission's conclusion did not meet the substantial evidence standard.43 The court stated that, in prin-

38. Id. at 259, 251 N.W.2d at 356.
39. Id. at 259-60, 251 N.W.2d at 356.
40. Id. at 260, 251 N.W.2d at 357.
41. Id. at 260-61, 251 N.W.2d at 357.
42. 302 N.W.2d at 9.
43. Id. at 11. Remanding commission determinations due to lack of adequate findings and reasoning is not rare in rate cases. While it is difficult to identify any clear standard consistently followed by a majority of state courts, it is clear that mere conclusory statements as to the general rate of return on common equity to be allowed are not enough to survive judicial review. See, e.g., Duval Util. Co. v. Florida Pub. Serv. Comm'n, 380 So. 2d 1028, 1031 (Fla. 1980) (conclusory statements by commission held insufficient to support findings as to conditioning service availability charges); People's Natural Gas Co. v. Pennsylvania Pub. Util. Comm'n, 47 Pa. Commw. 512, 409 A.2d 446 (1979) (remanded because commission merely listed factors and enumerated figures without articu-
ciple, the rate of return determination was not a complex one. Once the amount of common equity in the utility is determined, all that remains is for the commission to set a rate of return that is “sufficient to attract reasonable prudent investors.” The principle may be easy to state in the abstract, but when one focuses on the requirement and attempts to apply an economic analysis that fulfills the legal mandate, the problem becomes complex. The Maine Supreme Court has commented:

Our analysis of the record on this issue has demonstrated that the determination of the cost of equity is one of the most difficult and complex tasks facing the Commission. The Commission must utilize to the fullest its regulatory expertise and skill to analyze the highly technical economic and financial data presented on this issue. We cannot and will not attempt to second guess the Commission on such matters lying particularly within its area of expertise.

(See 302 N.W.2d at 11.)

(See ibid. at 636, 594 P.2d at 620 (citations omitted).)
The merit in the analysis of the Maine court is evident when the complexity of sub-issues in the rate of return determination is explored. The use of the discounted cash flow methodology is one such sub-issue.

IV. DISCOUNTED CASH FLOW METHODOLOGY

The Minnesota Public Utilities Commission relies heavily on the discounted cash flow (DCF) methodology to determine the rate of return on common equity.\textsuperscript{47} Other possible choices, such as the comparable earnings approach, the earnings/price ratio approach, and the spread between debt and equity approach have serious drawbacks.\textsuperscript{48} The DCF methodology suffers similar deficiencies. The necessity for some degree of informed judgment, based on experience and acquired expertise, in addition to analysis of economic data, is unavoidable in any rate of return determination, no matter what methodology is chosen.\textsuperscript{49}

\textsuperscript{47} In recent decisions, the commission has expressly stated its preference for the discounted cash flow methodology. In Northwestern Bell Tel. Co., Docket No. P-421/GR-70-388 (Minn. P.U.C. Apr. 4, 1980), the commission stated, “The Commission has evaluated all the testimony of the witnesses and relying on the record and on precedent has determined to place primary reliance on the discounted cash flow approach to the cost of equity.” \textit{Id.} at 50. In Continental Tel. Co. of Minnesota, Docket No. P-407/GR-79-500 (Minn. P.U.C. May 9, 1980), the commission stated, “In the Commission’s past decisions the Commission has not relied upon comparable earnings approach and has expressed a preference for the DCF method.” \textit{Id.} at 40. In the commission’s report that led to the Hibbing Taconite remand, the commission stated, “We have long accepted pure DCF testimony which is suitably adjusted where market pressure and costs of issuance are shown to exist.” Minnesota Power & Light Co., Docket No. E-015/Gr-77-360 (Minn. P.S.C. Feb. 3, 1978).

\textsuperscript{48} The “comparable earnings” approach was addressed by the commission in Continental Tel. Co. of Minnesota, Docket No. P-407/GR-79-500 (Minn. P.U.C. May 9, 1980). The commission stated:

The greatest difficulty with reliance upon a comparable earnings approach is in the selection of a group of companies which are perceived by investors as having comparable total risk to that of the utility for which a return is being set. How does one determine similarity of risk between companies?

\textit{Id.} at 40-41. The earnings/price ratio approach has also been expressly rejected by the commission. \textit{See id.} at 40; Otter Tail Power Co., Docket No. E-011/GR-77-916 (Minn. P.S.C. Aug. 1, 1978), at 26.

A relatively recent approach, the Capital Asset Pricing Model (CAPM), has received criticism for essentially the same reasons as the comparable earnings approach. The CAPM approach utilizes a portfolio of investments to determine cost and thus fails to consider the specific situation of the particular utility. \textit{See} Glassman, \textit{DCF v. CAPM (Is g better than b?)}, PUB. UTIL. FORT., Sept. 14, 1978, at 30.

\textsuperscript{49} For a discussion and explanation of the discounted cash flow methodology, as well as other approaches, see Kosh, \textit{The Determination of the Fair Rate of Return in Principle and Practice}, 12 PRAC. LAW., Nov. 1966, at 9. Kosh treats extensively both the economic and legal bases of the DCF methodology as well as discussing other approaches. \textit{See also} New
faced by the commission stems from the “end result” doctrine, not requiring any one specific methodology, the use of the DCF methodology is well-founded. An in-depth discussion of alternatives is not essential to understanding the court’s action in Hibbing Taconite.

DCF methodology is premised on the assumption that the market price an investor is willing to pay for stock is the present value of all future income from that stock. This income includes future dividend payments and the sales price when the stock is eventually sold; the expected future income is discounted to arrive at the present value of the future return.

The first aspect of the DCF methodology is relatively straightforward, though some judgment is invariably involved. An estimate must be made of the current and future dividend yield of the utility’s stock, as well as the stock prices in the future. In Hibbing Taconite, the commission relied on the “lowest expert’s” study falling within the range of reasonableness, pursuant to the North Central doctrine. The commission considered the low expert’s use of a Value Line Investment Survey that considered ninety-one electric utilities to estimate the current and future dividend yield, accepting the survey as a valid basis for the estimation. The use of some kind of average, either over time or of various other utilities, is justified because of the variable cost of stock from one day to the next. Since a rate determination stays in effect over a set period of time, the rate should not be overly dependent on stock prices at one particular moment. It should be noted at this point that the court in Hibbing Taconite did not single out the dividend yield determination for criticism, despite the fact that it was based on one expert’s opinion and conclusions, drawn from a ninety-one company sample, and rounded downward .03% by the commission to reflect factors brought out in another expert’s study.

The next step in determining the rate of return, utilizing the DCF methodology, is to determine growth rate. The growth rate

York Tel. Co., 92 P.U.R.3d 321 (N.Y. P.S.C. 1972) (discussion of several approaches to rate of return determination, covering approaches referred to as earnings-price ratios, discounted cash flow (both long term and short term), and bond yield correlation).


51. See infra notes 91-100 and accompanying text.


53. See 302 N.W.2d at 11.
reflects the future income the investor expects to receive from the eventual sale of the stock. One important feature of this calculation is that the actual growth rate of the utility is irrelevant. What is important is what the investor anticipates the growth rate will be.\textsuperscript{54} One need only look at price/earnings ratios listed in the \textit{Wall Street Journal} to appreciate the fact that investor expectations determine the ultimate sales price of any given stock. Since the rate of return is based on the necessity of attracting capital, it is this expectation that is sought to be quantified in the rate of return equation. It is this aspect of the rate of return issue that gives rise to serious problems of measurement. As one commentator stated, "The very characteristic of DCF analysis which makes it so attractive—its prospective gauge of the market—is also its most serious problem. Gauging investor expectations is no small feat. Use of the formula requires the analyst to assign a quantitative value to a nebulous 'feeling.'\textsuperscript{55}

The above discussion of the commission's approach to the rate of return issue illustrates that even though the determination may loosely be labeled a factual issue, not every sub-issue within rate of return is conducive to precise determination. For this reason, the court's broad characterization of rate of return as a more ascertainable issue than rate allocation is not accurate. The question that arises is how should judicial review be conducted to take into account the problems inherent in rate of return determinations? An alternative approach to judicial review of ratemaking is proposed in the next section.

V. An Alternative Approach to Judicial Review

Determining what the court would require in terms of details to justify the commission's determination of an appropriate growth rate is no easy task. The \textit{Hibbing Taconite} court chose to focus on an element in the rate of return equation that is perhaps the most speculative and conjectural of any single element. Determination of growth rate necessarily involves predictions, assumptions, and judgments.\textsuperscript{56} No matter how many hard data are available in the form of historical trends, market conditions or the status of the


\textsuperscript{55} Id.

utility as a mature versus expanding enterprise, the ultimate decision of the commission is necessarily based on agency judgment and expertise.

Despite classification of the rate of return determination as a factual issue, certain sub-issues like the growth rate are not precisely ascertainable and should not be held to the same standard of review as other more clear-cut factual issues. The court would be well advised not to rely on a blanket classification of all the issues involved in the rate of return decision, but rather, to focus on the particular issue at hand and apply a standard of review that is appropriate to that issue. The commission would not then be required to generate burdensome and unproductive explanations for decisions that cannot be precise, yet the court would still be able to judge the end result of the commission’s findings and apply judicial review for the purpose of overturning unreasonable or unsubstantiated decisions.

Past cases in Minnesota illustrate that the court looks carefully at the type of issue before granting any deference to an agency’s interpretation of its own statute. For example, in MPIRG v. Minnesota Environmental Quality Council, the court faced a challenge to an agency’s interpretation of a statutory term. The court stated, “Unless plaintiffs can show that the EQC’s [Environmental Quality Council’s] definition lacks a rational basis, this court must sustain that agency’s interpretation.” This holding resulted, in large part, from the lack of any statutory definitions of the term and the fact that several agencies were involved in the general controversy.

In contrast, no presumption of validity was accorded the Public Employment Relations Board in Hennepin County Court Employees Group v. Public Employment Relations Board. In Hennepin County, the Board interpreted statutory language referring to “essential employees” as not including court employees. The interpretation precluded court employees from having status as a separate bar-

57. 306 Minn. 370, 237 N.W.2d 375 (1975).
58. In MPIRG, the Environmental Quality Council interpreted the term “need for an environmental review” as required only upon a showing of “significant environmental effects resulting from any major governmental or private action of more than local significance.” Id. at 382, 237 N.W.2d at 382.
59. Id.
60. Id. at 382-84, 237 N.W.2d at 382-83.
61. 274 N.W.2d 492 (Minn. 1979).
62. Id. at 493.
The court refused to accord the normal deference to agency interpretation of statutes and stated that "when the area of regulation . . . is specifically within the court's particularized experience and expertise" the normal amount of deference need not be accorded the agency. The MPIRG and Hennepin County cases show that the court is willing to vary the scope of review depending on the issues of law involved and the amount of expertise in statutory interpretation possessed by the court.

Similarly, on issues of fact and the application of the law to the facts, while the general rule for the scope of review in Minnesota accords agency actions a presumption of regularity, and the challenger bears the burden of showing invalidity, it is clear that the nature of the facts and circumstances involved will affect the court's approach on review. In Reserve Mining Co. v. Herbst, the court gave recognition to the limited nature of judicial review, stating that "decisions of administrative agencies enjoy a presumption of correctness, and deference should be shown by courts to the agencies' expertise and their special knowledge in the field of their technical training, education, and experience." The court, however, considered at length evidence before the involved agencies and the basis of the agency's decision to minimize the environmental impact of a taconite tailings site by diffusing it into a sparsely settled area rather than into one which is more densely populated. Thus, in Herbst, the court afforded the agencies very little deference. Any presumptions of regularity were narrowly and strictly applied, the agencies' conclusions being subjected to close scrutiny by the court.

Historically, the court's approach to judicial review of utility commission rate determinations has been characterized by a considerably greater willingness to defer to the commission's expertise. In Northwestern Bell Telephone Co. v. State, the court characterized

63. Id.
64. Id. at 494.
66. 256 N.W.2d 808 (Minn. 1977).
67. Id. at 824.
68. Id. at 828-45.
69. 299 Minn. 1, 216 N.W.2d 841 (1974).
the entire ratemaking process as a legislative function and indicated that "great deference" should be accorded the commission. The commission was given a presumption of reasonableness as to the rate of return issue, the burden being on the challenger to show to the contrary by clear and convincing evidence. In a subsequent rate case involving Northwestern Bell Telephone Company, the court reaffirmed the principles announced in the preceding case, holding that the district court had erred by substituting its judgment for that of the commission.

The Hibbing Taconite decision is a radical departure from the past deferential attitude of the Minnesota Supreme Court and indicates that the court is now willing to subject the commission to much greater scrutiny on the rate of return determination. As earlier discussion has indicated, a sounder approach is to avoid a blanket classification of all issues involved in a rate of return decision by looking closely at each particular sub-issue involved in the overall rate of return determination and applying a standard of review appropriate to that particular issue. This is consistent with the court's earlier decisions and with federal court analysis of the issue.

VI. JUDICIAL REVIEW IN FEDERAL COURTS

The disparities and inconsistencies involved in the application of the substantial evidence standard of review are also present in federal cases. An analysis of the approach taken in several federal court cases will illustrate various views toward the proper application of the substantial evidence standard.

70. In Northwestern Bell, the court stated:
We have previously noted that the fixing of a fair rate of return cannot be determined with precision, since it is not derived from a formula, but must be reached through the exercise of a reasonable judgment. Ratemaking is a legislative and not a judicial function. In complex cases such as this, the court should, and does, accord the commission great deference in reviewing its decision.

Id. at 27-28, 216 N.W.2d at 857.

71. Id. Other state courts treat the entire ratemaking procedure as essentially a legislative function, subject only to the reasonable and non-arbitrary standard. See Mills v. Nebraska Motor Carriers Ass'n, 197 Neb. 159, 247 N.W.2d 619 (1976) (commission's decision deemed arbitrary and capricious only when no evidence supports its conclusions); Railroad Comm'n v. Houston Natural Gas Corp., 289 S.W.2d 559 (Tex. 1956) (court looked to end product of legislative determination and subjects commission to same scope of review as other legislative actions); see also City of Houston v. Public Util. Comm'n, 599 S.W.2d 687 (Tex. Civ. App. 1980); supra note 30 and accompanying text.

72. See Northwestern Bell Tel. Co. v. State, 253 N.W.2d 815, 820 (Minn. 1977).

73. The issue of the proper scope of judicial review has been discussed at length by commentators. See Kaufman, Judicial Review of Agency Action: A Judge's Unburdening, 45
In Ethyl Corp. v. Environmental Protection Agency, the District of Columbia Circuit Court of Appeals applied an arbitrary and capricious standard of review and held valid regulations passed by the Environmental Protection Agency (EPA) pursuant to informal rulemaking. The EPA regulations required phased-in reductions of lead content in gasoline.

The majority opinion went into an in-depth evaluation of the evidence considered by the agency and the procedures it followed, concluding that the agency followed all required procedures and that its conclusions had a rational basis. The case is interesting, not for its holding nor the majority opinion, but rather, for the vastly different approaches to judicial review advocated by two judges in concurring opinions. Judge Bazelon stressed the inadvisability of judges "steeping" themselves "in technical matters to determine whether the agency has exercised a reasoned discretion," and advocated that the emphasis upon judicial review should be focused on the procedures followed by the agency. He stated, "Because substantive review of mathematical and scientific evidence by technically illiterate judges is dangerously unreliable, I continue to believe we will do more to improve administrative decision-making by concentrating our efforts on strengthening administrative procedures." Judge Leventhal advocated quite a different approach in his concurring opinion, saying that judges must engage in some form of substantive review, though limited, by immersion in the record and analysis of the agency's reasoning.

In Industrial Union Department, AFL-CIO v. Hodgson, the District
of Columbia Circuit Court of Appeals faced a judicial review problem similar to that faced by a court applying a substantial evidence standard to rate of return determinations. In *Industrial Union*, standards for the regulation of asbestos dust in the atmosphere, promulgated by the Secretary of Labor pursuant to the Occupational Safety and Health Act of 1970 (OSHA), were challenged.\(^8\) The scope of judicial review was governed by a substantive statute that required a substantial evidence standard.\(^8\) This requirement presented a problem because some of the issues decided under the statute were not of a type conducive to substantial evidence review, the agency proceedings were conducted in an informal-formal hybrid mode,\(^8\) and the record generated by the agency was not "the form of one customarily conceived of as appropriate for substantial evidence review."\(^8\) The standard adopted by the court, when faced with this anomalous situation, is one which should serve as a model for state court review of rate of return determinations. In *Industrial Union*, the court stressed the need for flexibility in determining the proper scope of review, stating:

> Regardless of the manner in which the task of judicial review is articulated, policy choices of this sort are not susceptible to the same type of verification or refutation by reference to the record as are some factual questions. Consequently, the court's approach must necessarily be different no matter how the standards of review are labeled.\(^8\)

Once the need for flexibility is accepted, the court must require an adequate agency record so that a meaningful review can be made.

> What we are entitled to at all events is a careful identification by the Secretary, when his proposed standards are challenged,\

\(^8\). *Id.* at 470.  
\(^8\). *Id.* at 472-73.  
\(^8\). The court explained the procedures followed by the agency, stating:  
> Faced with the fact that his determinations were commanded by Congress to be reviewed under a substantial evidence standard, the Secretary did voluntarily move his procedures significantly toward the formal model. He directed that (1) a qualified hearing examiner should preside over the oral hearing, (2) cross-examination should be permitted, and (3) a verbatim transcript made. The total record in this case was in part created under the conditions that obtain in a formal proceeding. In substantial remaining part, however, it consists of a melange of written statements, letters, reports, and similar materials received outside the bounds of the oral hearing and untested by anything approaching the adversary process.  

*Id.* at 474.  
\(^8\). *Id.*  
\(^8\). *Id.* at 475.
of the reasons why he chooses to follow one course rather than another. Where that choice purports to be based on the existence of certain determinable facts, the Secretary must, in form as well as substance, find those facts from evidence in the record. By the same token, when the Secretary is obliged to make policy judgments where no factual certainties exist or where facts alone do not provide the answer, he should so state and go on to identify the considerations he found persuasive. 87

VII. APPLICATION OF INDUSTRIAL UNION SCOPE OF REVIEW

The *Industrial Union* approach is particularly well suited to state court review of utility commission rate of return determinations. Commission determinations of certain sub-issues in the rate of return calculation are not conducive to precise quantification. This is particularly true of the determination of growth rate. In this respect, the agency action is similar to the *Industrial Union* mix of policy and fact questions. Given the necessary application of agency judgment or expertise to given sub-issues, the court’s focus should be on the reasoning and the commission’s identification of pertinent factors, rather than on specific factual data justifying a particular rate of return.

The court’s requirement in *Hibbing Taconite* of greater factual detail in the commission’s report serves no useful purpose. 88 The inadequacy, if any, existed in the commission’s reasoning concerning why the agency chose the course that it did, not in the factual details. The issue is what considerations did the agency find persuasive in selecting the rate of return that fell between the two experts’ recommendations. To comply with the *Hibbing Taconite* court’s requirements, the commission would be forced to develop yet another study and analysis of the various factors that go into the growth factor determination. The end result of such a study would be no less speculative and judgmental than the figure arrived at from essentially splitting the difference between two expert’s testimony. It should be clear that such an exercise is ill-advised and unnecessary. In areas where agency expertise and judgment are necessarily a major factor in the ultimate conclusions reached by the commission, it is unwarranted for the court to make demands that the agency supply more than it is able to

87. *Id.* 475-76 (emphasis added).
88. The court stressed that the commission was to set forth *factual* support for its conclusion. 302 N.W.2d at 12.
VIII. THE NORTH CENTRAL DOCTRINE

The second significant aspect of the Hibbing Taconite decision is the court's rejection of the North Central doctrine as a valid method to evaluate expert testimony pursuant to the rate of return on common equity determination. By prohibiting the use of the North Central doctrine in the manner it did, the court has left considerable confusion as to how the commission is to approach evaluation of expert testimony in the future. An examination of the content and methodology of the doctrine, as well as an examination of how and when it is utilized by the commission, reveals no persuasive reason why its use should be prohibited.

The North Central doctrine was first articulated by the Minnesota Public Service Commission in 1977 as a method for determining the rate of return on common equity allowed a utility. The doctrine derives its name from the proceeding in which it was first used. See North Central Pub. Serv. Co., Docket No. E-101/GR-77-221 (Minn. P.S.C. Dec. 30, 1977). In that proceeding, the commission stated:

Fixing the rate of return on common equity is a legislative process. In the ideal sense, the Commission's obligation is to insure that a company has the opportunity to earn as much as it needs to maintain its financial integrity and provide adequate service and not a penny more. In exercising its mandate to protect the

89. No other state court has expressly imposed a Hibbing Taconite-type standard of review. Most courts accord utility commissions substantial deference. See, e.g., City of Cincinnati v. Public Util. Comm'n, 55 Ohio St. 2d 168, 378 N.E.2d 727 (1978) (commission's determination of rate of return held not unreasonable or unlawful in light of lack of evidence refuting testimony by staff expert relied upon by commission to determine range of reasonableness); United Tel. Co. of Iowa v. Iowa State Commerce Comm'n, 257 N.W.2d 466 (Iowa 1977) (court upheld commission determinations after concluding findings were based on substantial evidence and not arbitrary or capricious).

In United Telephone, the court discussed the amount of deference to be accorded the commission as to the rate of return determination in general and the use of a double leveraging approach in particular. Id. at 480-81. The court stated:

It is especially important to accord great respect to the Commission in a complex, esoteric area such as ratemaking in which the Commission has been entrusted with the difficult task of deciding among many competing arguments and policies. Our determination must focus on whether the result reached is arbitrary and appellant bears the burden of clearly demonstrating arbitrary action. . . . "Indeed, it has long been established that in matters relating to services and rates of utilities, technical data and expert opinion, as well as complex technological and scientific data, make it essential that the matter be considered by a tribunal that is itself capable of passing upon complex data." Id. at 481 (quoting Village of Apple River v. Illinois Commerce Comm'n, 18 Ill. 2d 518, 523, 165 N.E.2d 329, 331-32 (1960)); see also supra note 30.

90. See 302 N.W.2d 5, 11 (Minn. 1980); see also Minnesota Power & Light Co. v. Minnesota Pub. Serv. Comm'n, 310 N.W.2d 686 (Minn. 1981) (reaffirming court's rejection of North Central doctrine but not reversing commission's determination due to lack of prejudicial effect).

91. The doctrine derives its name from the proceeding in which it was first used. See North Central Pub. Serv. Co., Docket No. E-101/GR-77-221 (Minn. P.S.C. Dec. 30, 1977). In that proceeding, the commission stated:
trine appears to have two purposes. First, it is an effort to comply with statutory requirements providing that "[a]ny doubt as to reasonableness should be resolved in favor of the consumer." 92 Second, continued use of one basic method for evaluating expert testimony on the rate of return determination supplies consistency and predictability to an area fraught with difficulties. A general explanation of how the doctrine works and how it has been applied will illustrate how the above objectives are met.

Under the *North Central* doctrine, the commission considers the testimony and conclusions of all expert witnesses on the issue of the allowable rate of return on common equity. These witnesses testify on behalf of the various groups and businesses represented at the rate hearing. In a typical rate case, the groups represented include the utility seeking the rate increase, various intervenors—usually large commercial users like the Hibbing Taconite Company in the present case—the Administrative Division of the Minnesota Department of Public Service Staff (PDS), staff from the Office of Consumer Services (OCS), and various public interest groups such as the Senior Citizens Coalition of Northeastern Minnesota. 93 Not all of these groups supply expert witnesses to testify on the basis of economic studies, though they may still voice opinions and conclusions regarding the findings of experts presenting such testimony. 94

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Every rate made, demanded, or received by any public utility, or by any two or more public utilities jointly, shall be just and reasonable. Rates shall not be unreasonably preferential, unreasonably prejudicial or discriminatory, but shall be sufficient, equitable and consistent in application to a class of consumers. *Any doubt as to reasonableness should be resolved in favor of the consumer.* For rate making purposes a public utility may treat two or more municipalities served by it as a single class wherever the populations are comparable in size or the conditions of service are similar.

*Id.* at 31.


94. *See id.* at 21-26.
After the initial evaluation of all the offered testimony, the next step is to establish a range of reasonableness. The commission evaluates the testimony of all experts to determine if their recommendations fall within a range that is supported by substantial evidence in the record. The range itself is determined by evaluating all testimony, considering any applicable precedent, and applying accepted economic analysis.95 "The reliability of that range is checked by further review of the testimony of all parties using different approaches, and differences and similarities discussed."96 Recommendations that are either so high or so low as to not fall within the range of reasonableness are discarded. Such recommendations are deemed unsupported by evidence in the record and thus not based on the proper application of valid economic theories.

Once the range of reasonableness is established, the commission focuses on the lowest rate of return recommended that falls within the range. If the lowest recommendation falls within the range and retains its validity through cross-examination and criticism by other parties to the proceeding, it will be accepted. In the event valid criticisms are made, however, the recommendation is examined to determine if it can be adjusted to take the criticisms into account. Should no adequate adjustment be possible, the recommendation is discarded and the next lowest recommendation is put through the same process. Once a recommendation survives the process of evaluation, it is adopted and becomes part of the overall rate of return determination.97 In defense of the North Central doctrine, the commission has stated, "Selection of the lowest (adjusted) recommendation on this basis is consistent with due process, with logic, and with the Commission determination to resolve doubtful questions in favor of the rate payer."98

In the rate proceeding considered by the court in Hibbing Taconite, the commission considered testimony of the company witness, Mr. Benderly, and the DPS witness, Mr. Miller. Both witnesses’ testimony was explained and evaluated at length. Criticisms of each were considered and discussed. Both were found to fall within the range of reasonableness determined by the commission. Mr. Miller’s recommendation was the lower of the two and was

96. Id.
97. Id.
98. Id. at 11.
thus subjected to further in-depth analysis. In response to criticisms raised by Mr. Benderly, Mr. Miller's recommendation was adjusted upward to reflect three factors not adequately considered in his own study. Adjustments for the particular risk of MP&L, market pressures, and cost of issuance of new stock resulted in an upward revision of the end result of the study by .7%. In addition, the growth rate factor was a compromise between Mr. Miller's and Mr. Benderly's figures.99

Use of the North Central doctrine was challenged by MP&L. The company claimed that the doctrine resulted in an arbitrary determination of the rate of return based on one expert's testimony with an improper lack of regard for the testimony of other witnesses. This challenge was the subject of a rehearing petition, pursuant to which the commission issued supplementary findings and conclusions.100 The issues raised by the company in its rehearing petition are essentially the same issues the court in Hibbing Taconite used to explain its prohibition of the use of the doctrine.

In Hibbing Taconite, the court stated that the use of the doctrine was not acceptable. "To peg an established rate to a rate advocated by any one of several expert witnesses is an arbitrary delegation of that duty."101 The court's terse rejection of the North Central doctrine seems unwarranted in light of the lack of any universally accepted alternative, the court's apparent approval of the method actually employed by the commission in the case (stated by the commission to be the North Central doctrine),102 and the applicability of the substantial evidence standard of judicial review.

The court called the North Central doctrine an "arbitrary delegation" of the duty to set a just and reasonable rate. The question arises whether it is in fact arbitrary. The commission does not pick an expert out of a hat and then apply his or her conclusions to determine the appropriate rate of return. All challenges and criticisms of the "low expert" are given consideration. If the "low expert's" testimony is not adequately supported by valid findings

100. Id. (Supplementary Findings June 19, 1978).
101. 302 N.W.2d 5, 11 (Minn. 1980).
102. Id. In a somewhat novel finding, the court forbids the use of the North Central doctrine in future cases though not remanding the case on the basis of its use in Hibbing Taconite. Despite express statements by the commission that this was the method used, the court felt that the doctrine had not been applied by the commission in Hibbing Taconite. Id.
and theories, it is discarded. Thus, for the low estimate to become the basis for the rate of return determination it must (1) be based on sound theories and facts, (2) fall within the range of reasonableness, and (3) be able to survive cross-examination by the various competing interests represented at the hearing. Further, it is adjusted to more accurately reflect factors not originally considered in the testimony. In this way, no one expert is relied upon to the exclusion of the other experts. It is difficult to see how the court can say such a method is arbitrary, or even that the ultimate rate of return is "pegged" on one expert over another to the extent that the result is unreasonable.

The doctrine as applied by the commission in *Hibbing Taconite* calls for careful analysis of the testimony of each expert (1) to establish the range of reasonableness and (2) to bring out criticisms of and possible adjustments to the estimates of the other experts. If the commission fails to analyze the testimony of the other experts, it is clearly not following the approach of *Hibbing Taconite* and the commission is arbitrarily delegating its duty to set a just and reasonable rate. In *Minnesota Power & Light v. Minnesota Public Service Commission*, the court found, "There is no indication in the PSC's decision that it analyzed the testimony concerning the 13.75 percent rate of return on common equity recommended by MPL's witness, Fraser." Later in the opinion, the court notes, "A recitation of the testimony presented is not a substitute for findings and conclusions by the PSC." This seems a sound result. Analysis of each expert's testimony and the commission's reasoning in reaching its conclusions should be apparent in the findings.

If the *North Central* doctrine, as applied in *Hibbing Taconite*, does not result in an arbitrary delegation of the duty to set just and reasonable rates, does it pass the substantial evidence test? The court implicitly acknowledged the validity of the doctrine under this standard of review by refusing to remand the commission's

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103. 310 N.W.2d 686 (Minn. 1981).
104. *Id.* at 689 (emphasis added).
105. *Id.* The court was not persuaded that this failure of analysis was sufficiently prejudicial to require reversal because the injustice was corrected by the PSC's decision to allow a current return on a portion of construction work in progress funds. *Id.* at 690. The principle thus adopted, that an error in analysis of one issue can be compensated for by correct analysis of an entirely different issue, seems irrational. Even if the current return on construction work in progress does lower the cost of equity from what it would have been without this relief, it would be totally fortuitous for this decrease in the cost of equity to approximate the upward adjustment if any resulting from the commission's proper analysis of the highest expert's estimate of rate of return. See *id.* at 690 n.7.
determination on the basis of the method actually used in the rate proceeding under consideration.\textsuperscript{106} A close look at the commission's analysis reveals that the method it employed resulted in a decision based on substantial evidence. The commission discussed each element of the "low expert's" study. It found one element no worse than that of the other expert (cost of equity based on a ninety-one member index of other utilities). It then split the difference between the two experts on the growth rate factor, accepted as presented the risk factor element, and accepted the highest expert recommendation as to the adjustment for market pressure and cost of issuance of stock in the near future. This last adjustment was made despite the fact that the "low expert" recommended that no adjustment be made at all. The market pressure and cost of issuance adjustments were made in response to the "high expert's" criticisms and recommendations. Thus, out of four main elements of the "low expert's" study, only one was accepted without change. The remaining three factors were all adjusted to be brought closer in line with the "high expert’s" recommendations.\textsuperscript{107}

The court singled out the growth factor determination as an example of a commission determination not supported by sufficient facts. The problem, if any, is not in the facts, but rather in the need for more reasoning in determining to split the difference between two experts on this factor. The commission should certainly explain its reasoning, but the court must keep in mind that commission expertise and judgment play a large role in this issue.

If the \textit{North Central} doctrine results in such close scrutiny of expert testimony on a subject as elusive and controversial as the rate of return on common equity, it is hard to accept the court's rejection of the method. The commission would be well advised to perform essentially the same analysis in the future but without calling it by name, thus possibly avoiding the court's reprimand in future rate cases. While the \textit{North Central} doctrine may not be the most scientific and precise procedure possible, it has the virtue of being consistent with the statutory mandate to resolve doubts in favor of consumers,\textsuperscript{108} allows elements of all the experts' testimony to be considered and incorporated to some extent in the rate of return

\textsuperscript{106}. 302 N.W.2d 5, 11 (Minn. 1980).
\textsuperscript{108}. See supra note 93.
determination, and if consistently applied, supplies a degree of predictability to the commission's procedures for determining the allowable rate of return on common equity.

The court's fear that the use of the North Central doctrine will result in arbitrary and unreasonable determinations is further undercut by the commission's own view of the proper use of the doctrine. The commission has shown that it is not insensitive to the court's criticism of the doctrine by refusing, on its own initiative, to apply the doctrine when it is not appropriate or helpful to a reasonable and supported determination. Minnesota Gas Co., 109 is one rate proceeding in which the doctrine was not applied. In Minnesota Gas, there was no expert testimony that withstood careful examination. The company's witnesses supplied no adequate methodology to support their recommendations. They merely sought to show that their recommended percentage was sufficient to attract capital, not attempting to show that a lower percentage would not be sufficient to attract capital. The Participating Department Staff witness failed to adequately consider the utility's unique circumstances and thus did not provide any acceptable basis upon which to determine the rate of return. The commission's response, when faced with no adequate recommendation, was to perform its own in-depth analysis of the issues involved, considering all relevant factors raised by all the testifying witnesses. The apparent willingness of the commission to undertake its own independent and thorough consideration of all the issues, abandoning the North Central doctrine when no testimony is sufficient to justify a recommended rate of return, should allay the court's fears regarding the use of the North Central doctrine.

In addition, there are few, if any, issues involved in the ratemaking process other than the rate of return on common equity that give rise to an opportunity for the commission to fulfill the statutory mandate to resolve doubts in favor of the consumer. The very language of the statute requires, "Any doubt as to reasonableness should be resolved in favor of the consumer." There are no other issues in which reasonableness is such a major component. The North Central doctrine gives meaning to the statutory require-

110. Id. at 36-37.
111. Id. at 38.
112. Id. at 39.
113. Id. at 39-47.
ment by focusing on the lowest recommendation that falls within a range of reasonableness. Nevertheless, the court characterized the North Central approach as arbitrary and capricious. It is difficult to reconcile this holding with the policy articulated by the statute. One interpretation of the court's objection to the North Central doctrine is that the court itself did not fully understand the doctrine, relying instead on the erroneous assumption that the commission did not evaluate all the expert testimony offered. If this is the case, then the court has not prohibited the use of the North Central doctrine. It merely imposed on the commission an obligation to apply it in a thorough and well considered manner, such as it did in Hibbing Taconite.

IX. Summary

The Hibbing Taconite decision imposes a substantial evidence test on "quasi-judicial" rate of return determinations by the utilities commission but grants a presumption of validity to "legislative" rate allocation decisions. This bifurcation of the scope of review on ratemaking decisions misapprehends both the nature of the decisions to be made by the commission, particularly on the rate of return issue, and the court's intellectual function in reviewing these decisions.

The rate of return determination in ratemaking is, in fact, a complex and difficult task, demanding the application of expert judgment. The rate allocation decision rests on a combination of determinable facts as well as policy judgments. The court draws overbroad distinctions between the two determinations. The result is to subject the commission to too little review on rate allocation decisions and too strict a review on rate of return issues.

The court should avoid reliance on overbroad scope of review labels and focus instead on the type of fact that is being determined by the agency and the intellectual function to be performed by the reviewing court with respect to that type of fact. Thus, where the act of decision is essentially a prediction based on expert judgment, the reviewing court should first focus on such fundamental facts as should be clear in the record, and second on the reasoning underlying the ultimate policy judgment. If the act of decision is clearly legislative, like income redistribution, the court should focus on the agency's reasoning.

The North Central doctrine is not an arbitrary delegation of the duty to set just and reasonable rates. The doctrine, when properly
applied, demands analysis of all experts' testimony and has the virtue of being consistent with the statutory mandate to resolve doubts in favor of consumers.