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IN THE COURT OF APPEALS OF IOWA

PARK VIEW UTILITIES COMPANY, Petitioner-Appellee-Cross Appellant,	)	Filed April 29, 1980
vs.	)	
IOWA STATE COMMERCE COMMISSION,	)	360 2-63168
Respondent-Appellant-Cross Appellee.	)	

Appeal from Scott District Court - Allan L. Keck, Judge.

Agency appeals from district court order reversing disallowance of utility's rate increase; utility cross-appeals. Affirmed in part, reversed in part.

James R. Maret, Commerce Counsel, and Diane L. McIntire, Assistant Commerce Counsel, for respondent-appellant-cross appellee.

Donald H. Sitz of Lane & Waterman, Davenport, for petitioner-appellee-cross appellant.

Heard by Oxberger, C.J., and Donielson, Snell, Carter, and Johnson, JJ.

DONIELSON, J.

Respondent, Iowa State Commerce Commission (Commission), appeals district court order reversing disallowance of rate increase for petitioner, Park View Utilities Company (Park View). Commission asserts district court exceeded the proper scope of its review and the Commission's findings and conclusions, supported by substantial evidence in the record, were not arbitrary, capricious, unreasonable, or confiscatory. Park View cross-appeals the part of the district court order upholding Commission's use of an average rather than a year-end rate base, asserting this technique was arbitrary, capricious, and unreasonable and deprived it of property without due process of law. We affirm the district court order in part and reverse in part.

I.

On June 30, 1976, Park View, a public utility subject to the rate jurisdiction of Commission under Chapter 476, The Code 1975, filed with Commission a new rate tariff providing a twelve per cent increase in its rate schedules. Commission suspended the tariff and initiated an investigation. Pursuant to statutory authority, the proposed rates became effective August 2, 1976, subject to possible refund. Following hearings, Commission disallowed on November 23, 1977, the rate increase in its entirety and ordered a refund of sums collected in excess of those authorized under the prior rate schedule. Commission denied Park View's application for rehearing.

Pursuant to section 17A.19, The Code 1977, Park View sought judicial review of Commission's disallowance, challenging three aspects of Commission's order, as follows:

> 1. Commission erred in using an average rate base for test year 1975, rather than a year-end rate base.
>
> 2. Commission erred in refusing to include in the cost of service or rate base the full amount of salaries paid to Park View Officers and in allocating fifty per cent of the reduced salaries to rate base rather than thirty per cent as in prior cases.
>
> 3. Commission erred in determining fair and reasonable rate of return on rate base should be 8.8977%, rather than 10.3% sought by Park View.

The district court affirmed Commission's use of an average rather than year-end rate base, but reversed the Commission's findings on the other issues. The court order, filed January 29, 1979, directed an allocation of the salaries of Park View's officers to

operating expenses and set overall rate of return to be allowed Park View. Both parties appeal adverse aspects of the order.

II.

Our task is to review the record in the manner specified in section 17A.19(7) and make anew the judicial determination specified in section 17A.19(8). Hoffman v. Iowa Department of Transportation, 257 N.W.2d 22, 25 (Iowa 1977); see Davenport Community School District v. Iowa Civil Rights Commission, 277 N.W.2d 907, 909 (Iowa 1979); Davoren v. Iowa Employment Security Commission, 277 N.W.2d 602, 603-04 (Iowa 1979); Taylor v. Iowa Department of Transportation, 260 N.W.2d 521, 522 (Iowa 1978). In the posture of this appeal, this court's duty is to correct errors of law made by the district court. Jackson County Public Hospital v. Public Employment Relations Board, 280 N.W.2d 426, 429 (Iowa 1979); § 17A.20; see Iowa R. App. P. 4.

When the district court acts pursuant to section 17A.19, it is itself acting in an appellate capacity to correct errors of law specified in section 17A.19(8). Iowa Public Service Co. v. Iowa State Commerce Commission, 263 N.W.2d 766, 768 (Iowa 1978). When this court reviews a decision of a district court rendered pursuant to section 17A.19, the sole question facing us is whether the district court correctly applied the law. Jackson County Public Hospital, 280 N.W.2d at 429. Resolution of this question requires applying "the standards of section 17A.19(8) to the agency action to determine whether this court's conclusions are the same as those of the district court." Jackson County Public Hospital, 280 N.W.2d at 429-30. If the conclusions are the same, affirmance is appropriate. If the conclusions differ, reversal may be required. Id. at 430; see Briggs v. Board of Directors, 282 N.W.2d 740, 743 (Iowa 1979). Our review is limited, as was the district court's review, to the record made before the Commission. City of Des Moines v. Iowa State Commerce Commission, 285 N.W.2d 12, 14 (Iowa 1979).

III.

In its appeal to the district court, Park View challenged the Commission order principally on the grounds: the findings were "unsupported by substantial evidence in the record made before the agency when that record is viewed as a whole," § 17A.19(8)(f); the order was unreasonable, arbitrary or capricious, § 17A.19(8)(g); and confiscation of property without due process of law, U.S. Const. amend. XIV; Iowa

Const. art. I, §§ 6, 9. Commission contends its order was supported by substantial evidence in the record, was not unreasonable, arbitrary or capricious, and thus not an unconstitutional confiscation. Our analysis will be structured along these lines in examining Park View's arguments.

Initially, we note Park View has the burden of proving Commission's reinstatement of the prior rate schedule is unreasonable, confiscatory, or violative of constitutional immunities. See City of Des Moines v. Iowa State Commerce Commission, 285 N.W.2d 12, 16 (Iowa 1979); Davenport Water Co. v. Iowa State Commerce Commission, 190 N.W.2d 583, 590 (Iowa 1971). A rate fixed by the Commission for a public utility is presumed to be valid and reasonable. City of Des Moines, 285 N.W.2d at 16.

Important to our consideration is the notion of substantial evidence, which has been defined in many ways. Generally, substantial evidence is evidence that would justify refusal to direct a verdict. Grant v. Fritz, 201 N.W.2d 188, 197 (Iowa 1972). It is more than a scintilla of evidence, but less than a preponderance. Id. Substantial evidence has probative force on the issues and from which the trier of fact can reasonably decide the case on fact issues, or is evidence favoring facts on which reasonable persons may differ. Id. "[T]he possibility of drawing two inconsistent conclusions from the evidence does not prevent an administrative agency's finding from being supported by substantial evidence." Briggs, 282 N.W.2d at 743. The focus is on whether the agency's decision is supported by substantial evidence in the record, not whether a decision it did not make is likewise supported. See Davenport Water Co., 190 N.W.2d at 591-92.

A.

Park View contends Commission erred in using an average rate base for test year 1975, rather than a year-end rate base. It argues use of an average rate base in the context of this case is arbitrary, capricious, unreasonable, and unconstitutionally confiscatory. While conceding the use of an average rate base is generally acceptable, Park View points to several aspects of this case that militate against its use. These include allegedly severe and continuing company losses, Commission's denial of a portion of its actual operating expenses, and the setting of artificially low rates of

return. It also argues use of an average rate base distorts future conditions for a company like itself: a young company experiencing extraordinary growth.

The rate base is the depreciated value of the utility's plant and property devoted to the public service. The rate base is multiplied by the allowable rate of return to determine the permitted dollar amount of operating income, which pays interest on the utility's bonds and furnishes a return to stockholders. The approved operating expenses are added to the allowed operating income to determine the gross revenues the utility should receive.

Commission relied on the testimony of Commission staff witness Arndt as supporting its use of an average rate base. The rationale for the choice of rate base methodology made by the Commission is set forth in Arndt's testimony:

> Q. Why did you reject Mr. Millage's use of a year-end rate base?
>
> A. Mr. Millage failed to properly match test year revenues and expenses with rate base by using a rate base at the year-end level without recognizing the effect of additional customers and usage which also resulted at the year-end level. As shown in Company's 1975 Annual Report, the number of customers grew from 456 on January 1, 1975, to 498 on December 31, 1975. In addition, customers in 1975 used an average of 8,292 kwh—717 percent more than they used in 1974 and 20.8 percent more than they used in 1973. Failure by Company to recognize the effect of new residential and commercial customers and increased usage results in an understatement of net income relative to test year rate base.
>
> Q. Why do you recommend that an average rate base be used?
>
> A. In determining revenue requirements, the adequacy of the rate of earnings is measured by the relationship of operating income to rate base. Operating income for rate making purposes is usually calculated on the basis of operations for a 12-month period. It is my belief that to achieve a proper relationship, operating income for a 12-month period must be matched with the average amount invested for that same period. This relationship avoids the inconsistencies which arose with Mr. Millage's use of a year-end rate base.

A reasonable person could conclude from this uncontroverted testimony that use of an average rate base was proper in this case, thereby allowing a finding of substantial evidence supporting Commission's action. During the test year, additions were made to Park View's plant that may be expected to generate revenues not fully realized during

the test year. Use of an average rate base is more appropriate in obtaining correct matching of revenue and expenses. See Davenport Water Co., 190 N.W.2d at 605. We affirm the district court's holding that Commission's use of an average rate base was supported by substantial evidence in the record. See General Telephone Co. of the Midwest v. Iowa State Commerce Commission, 275 N.W.2d 364, 367-68 (Iowa 1979).

B.

Park View contends Commission erred in refusing to include in cost of service or rate base the full amount of salaries paid to Park View's officers and in allocating fifty per cent of the reduced salaries to rate base rather than thirty per cent as in prior years. The principal owners and officers of Park View, F. Marion Olds, Sr. and Richard E. Millage, were each paid a salary of $6000 in 1975. Commission allowed $3500 per officer for ratemaking purposes, primarily because no allegedly verifiable showing was made by Park View that the services performed warranted a $6000 salary for each officer. Commission allocated fifty per cent of the reduced total salary amount to the plant account and the remaining fifty per cent to operating expenses.

Park View argues these salaries were actually incurred and were warranted as reasonable compensation for services performed by the officers. It admits the noncompliance of its record-keeping procedure with previous Commission orders, but contends the salaries were reasonable compensation for the officers' efforts on behalf of Park View and the required record-keeping was for the purpose of allocation of the salaries between plant and operating expenses. Park View did not challenge at trial Commission's allocation of salaries between the plant account and operating expenses. Park View contends, however, Commission never suggested the time records were necessary to justify the amount of the salaries. Park View also asserts Commission previously accepted testimony regarding an officer's duties unsupported by such records, with respect to it and other utilities. In sum, Park View asserts Commission's disallowance of a portion of the officers' salaries for lack of proof is without substantial evidence.

Commission argues Park View offered no verifiable proof concerning the reasonableness of the officers' salaries. Aggravating Park View's dearth of evidence, Commission contends, is the self-dealing nature of this case where the two officers

owned nearly all of Park View's common stock and, as the Board of Directors, voted themselves the yearly salary. Thus, the actual incurral of this expense and the officers' testimony must be scrutinized. We agree with Commission under these circumstances more proof is required than mere descriptions of activities engaged in or their reasonableness.

Park View's evidence consisted of Millage's general statement of his duties. No evidence was offered as to the amount of time Millage spent, aside from his estimate of about ten per cent of his time, or the value of his services. There also was no direct evidence describing Olds' activities. In this context, the entire $12,000 could have been disallowed. Commission's disallowance of $5000 did not prejudice Park View's substantial rights. § 17A.19(8).

Park View's comparison of the officers' salaries to its assets, gross income, and operating expenses has little or no relevance to the reasonableness of these salaries. Park View's claim that Commission's previous allowances of these salaries creates a presumption of reasonableness is without merit. Since ratemaking is prospective, the Commission is not bound to follow conclusions reached in prior cases when there are different circumstances. See Togg Brothers & Moorhead v. United States, 280 U.S. 420, 444-45, 50 S. Ct. 220, 226, 74 L. Ed. 524, 537 (1930); State ex rel. General Telephone Co. of the Midwest v. Public Service Commission, 537 S.W.2d 655, 661-62 (Mo. Ct. App. 1976). Viewing the record as a whole, we find substantial evidence supporting Commission's disallowance of $5000 from the officers' salaries; the district court erred in finding otherwise.

The district court also erred in reversing Commission's allocation of officers' salaries between plant and operating expenses and mandating Park View's proposed allocation be used. Park View admits it did not argue this issue to the district court. As noted, Commission's previous rulings on this matter are not binding or preclusive. A district court cannot reverse a Commission fact-finding or legal analysis on an issue that has been waived. See Alpen v. Chapman, 179 N.W.2d 588, 593 (Iowa 1970); Dickinson v. Mailliard, 175 N.W.2d 588, 597 (Iowa 1970). We reverse the district court's holding on these two items.

C.

Park View also alleges Commission erred in determining the fair and reasonable average rate of return on the rate base should be 8.8977%, rather than the 10.3% sought by Park View. Park View's requested 10.3% return was arrived at by determining the actual contractual interest on borrowed capital, assigning a fourteen per cent rate of return to common stock, and combining these elements into a weighted average, as follows:

	Amount	Percent	Rate	Weighted
Debt:				
Eastern Iowa	$52,414	19.43%	8.5%	1.65%
Eastern Iowa	46,428	17.21	7.875	1.36
Eastern Iowa	16,182	6.00	7.2	.44
Olds Constr.	31,209	11.57	9	1.04
Davenport Bank	40,000	14.83	10	1.48
Equity:	83,500	30.96	14	4.33
	$269,733	100.00%		10.30%

The Commission allowed an overall rate of 8.8997%. This rate of return was arrived at by three adjustments to Park View's calculations, as follows:

> 1. Reduction of the rate of interest on part of Park View's debt to post-test year levels.
>
> 2. Reduction of equity component of the capital structure by subtracting from total amount invested ($83,500) the amount of prior years' losses.
>
> 3. Reduction of the requested fourteen per cent equity rate to approximately 12-1/2%.

Park View contends the first adjustment violates regulatory rules prescribed by the supreme court and followed in the past by Commission. See Davenport Water Co., 190 N.W.2d at 605-06. Park View, noting Commission's arguments in other cases, argues the principle of matching costs and revenues incurred within the test year precludes the use of known post-test year cost changes without considering other, possibly offsetting changes. The purpose of using a test-year is to combine all factors affecting rates in the same time period. See id.

Park View asserts the supreme court held in Davenport Water Co., that there must be a matching of costs and revenues within the test year. Id. at 605-06. A close reading of the facts of that case reveals a much narrower holding. Id. We read Davenport Water Co., to hold the matching principle does not require inclusion of costs

in the rate base, when any derived potential revenues or other offsetting changes are not also included into the calculus of the decision. Id. Here, Commission's adjustment involved a known decrease in the interest charge to be incurred by Park View for existing facilities. No other offsetting changes were established. We find Commission's action consistent with the holding of Davenport Water Co., id, and supported by substantial evidence in the record. District court erred in holding otherwise.

Commission's second challenged adjustment was an alleged reduction in the equity component of the weighted average calculation of the overall rate of return. Commission reduced the total amount invested ($83,500) by the amount of prior years' losses ($10,067). Park View argues this is unconstitutionally confiscatory because it prevents Park View's stockholders from receiving a fair return on investment. It contends Commission's adjustment means the more Park View loses, the less it will be entitled to earn.

Commission contends it did not reduce the equity component, but rather recognized the actual nature of Park View's capital structure by recognizing through a standard balance sheet calculation its negative retained earnings. To do otherwise, Commission argues, would overstate Park View's equity position. In effect, Commission rejected Park View's proposal to recognize past losses as if they were capitalized and included in the rate base.

Initially, we find Commission's choice of ratemaking methodology was supported by substantial evidence in the record as it was based on expert, unimpeached testimony. Such a finding requires reversal of the district court's holding on this matter. See Jackson County Public Hospital, 280 N.W.2d at 429-30. Moreover, we find the Commission's action reasonable. The focus of ratemaking is primarily prospective: past losses may not be set off by setting higher future rates. See generally Arizona Grocery Co. v. Atchison Topeka & Santa Fe Railway, 284 U.S. 370, 389-90, 52 S. Ct. 183, 186, 76 L. Ed. 348, 355-56 (1932); Bluefield Water Works & Improvement Co. v. Public Service Commission of West Virginia, 262 U.S. 679, 694, 43 S. Ct. 675, 679, 67 L. Ed. 1176, 1183 (1923). Since losses reduce an investor's investment, it is a mere recognition of economic reality that the future return may be less. The due process clause has never been held

to require a commission to fix rates on the historical calculation of property whose history and current financial statements show the value no longer exists, or on an investment after it has vanished. See Market Street Railway v. Railroad Commission of California, 324 U.S. 548, 567, 65 S. Ct. 770, 779-80, 89 L. Ed. 1171, 1184-85 (1945). District court erred in reversing Commission on this matter.

Commission's reduction of the requested fourteen per cent rate of return on equity to 12.3%-12.6% is also challenged by Park View. Park View contends the rate found by Commission understates its cost of equity by assigning an inadequate risk differential between itself and six major Iowa electrical utilities. Commission found the risk differential between Park View and the six large electric utilities to be between 1.2% and 1.4%. When added to the calculated cost of equity of 11.1% to 11.3%, the allowed equity rate, however, was no greater than that allowed the other compared utilities. This claim is legally and factually insufficient to warrant reversal of the Commission. Each ratemaking case is decided on its own unique facts to ensure a reasonable rate is set. Comparison to the rates allowed to other utilities thus provides little guidance and certainly no binding precedent. See generally Bluefield Water Works & Improvement Co., 262 U.S. at 692-94, 43 S. Ct. at 679, 67 L. Ed. at 1182-83.

The rate set by Commission was supported by the expert testimony of staff witness Rasmussen. The only evidence presented by Park View for the fourteen per cent return on equity was presented by Millage, who based his recommendation, not on supporting data or methodology, but on the occurrence of past losses and rising operational costs. While Park View is small and its ability to marshall support for its proposed rate increase limited, this does not excuse it from meeting its burden of proving its case. District court erred in reversing Commission on this matter.

In the area of ratemaking, Commission possesses special expertise in the analysis of data and determination of proper and reasonable rates. Its findings, if reasonable and supported by substantial evidence in the record, should be affirmed on appeal. The district court failed to limit its analysis in this manner and proceeded to substitute its judgment for the Commission's. We reverse the district court order to the extent it

reversed the Commission and affirm the Commission's order in all respects. Park View shall pay the costs of this appeal.

AFFIRMED IN PART, REVERSED IN PART.