COURT OF APPEALS
DECISION
DATED AND FILED

February 28, 2002

Cornelia G. Clark
Clerk of Court of Appeals

NOTICE

This opinion is subject to further editing. If published, the official version will appear in the bound volume of the Official Reports.

A party may file with the Supreme Court a petition to review an adverse decision by the Court of Appeals. *See* WIS. STAT. § 808.10 and RULE 809.62.

Appeal No. 01-1678 **Cir. Ct. No. 00-CV-3095**

STATE OF WISCONSIN **IN COURT OF APPEALS**
DISTRICT IV

CITY OF MADISON, DANE COUNTY, AS A WATER PUBLIC UTILITY,

PETITIONER-RESPONDENT,

V.

PUBLIC SERVICE COMMISSION OF WISCONSIN,

RESPONDENT-APPELLANT.

APPEAL from an order of the circuit court for Dane County: STEVEN D. EBERT, Judge. *Reversed.*

Before Vergeront, P.J., Dykman and Roggensack, JJ.

¶1 VERGERONT, P.J. The Public Service Commission (PSC) denied the application of the City of Madison, as a public water utility, for a rate increase to fund reimbursement to utility customers who were required to replace lead laterals on their properties. The circuit court reversed that decision, and the PSC appeals. The PSC contends that its decision denying the application is reasonable

and is supported by substantial evidence in the record, and therefore it must be affirmed. We agree and reverse the circuit court's order.

BACKGROUND

¶2 The relevant facts, as found by the PSC, are not in dispute. The U.S. Environmental Protection Agency (EPA) regulates the level of lead and copper metals in drinking water. The City of Madison, as a public water utility, did not meet EPA lead requirements, and was therefore required to take action to reduce lead levels. Failure to comply would result in fines of up to $25,000 per day.

¶3 Lead laterals were installed in Madison until 1927. The utility owns the street portion of the lateral and the customer owns the lateral from the curb into the building. There are an estimated 9,000 customer-owned lead laterals remaining in Madison and 4,000 city-owned laterals.

¶4 The City determined that the addition of the chemical Orthophosphate to the water supply would probably enable it to comply with federal and state regulations. The costs of the chemical would be passed on to all utility customers. However, the addition of the chemical would adversely affect surrounding lake vegetation and algae growth. In addition, the chemical treatment would continue indefinitely.

¶5 As an alternative to the chemical treatment, the City proposed to replace all remaining lead laterals within the city, including both the utility-owned street portion and the customer-owned portion from the curb to the building. The estimated annual cost of replacement would be less than that of chemical treatment, and replacement would be completed within ten years.

¶6 The Madison Common Council enacted an ordinance requiring the replacement of the customer-owned portion of the lead laterals and providing for a 50% rebate of the cost of lead lateral replacement up to $1,000 retroactive to 1992. The replacement program was to be funded from utility reserves and a proposed rate increase in the form of a 5.5 cent surcharge per hundred cubic feet on all water sales for ten years. The surcharge would result in an annual charge of $5.10 per year per customer. The City applied to the PSC for authority to increase water rates.

¶7 The PSC denied the application. The PSC acknowledged that the record supported the City's decision that the replacement alternative was the better means of compliance with the EPA standards; however, the PSC concluded that it would be unreasonable and unjustly discriminatory if public dollars generated through utility rates were used to subsidize a direct benefit to an exclusive group of private property owners. The PSC explained:

> The Commission generally sustains the policy that where benefits accrue to the public at large from a municipal program elected by local government that all associated funding needs should properly be the responsibility of that local unit of government. In this case it would be inappropriate for a funding mechanism to be hidden in a public utility rate, especially where the proceeds go to aiding a select few and are not generally available to widely qualifying customers of the public utility. The City passed the ordinance requiring property owners to replace their lead laterals. It therefore is the appropriate body with the necessary authority to provide any subsidy to assure the success of the replacement program. The Commission believes it would establish an unwise precedent for cash flows generated from charges to public utility customers to be put toward a subsidy which clearly and directly benefits a specific group of private property owners.

¶8 The PSC also stated:

> The reasonableness of the subsidy by ratepayers is further called into question when recognizing that the lead service laterals have been in place since 1927, or earlier. The [utility's] depreciable life for laterals is 60 years. Notably, these lead laterals are fully depreciated from an accounting standpoint. While many may have practical service life remaining, others could be in need of replacement in the not too distant future. In Madison, as in most if not all other Wisconsin municipalities, it is the property owner who is responsible for the repair and ultimate replacement of the customer portion of the lateral. It is reasonable to assume that the owners of the properties in the Isthmus/Capitol area knew or should have known of the lead lateral liability and of the potential need for lateral replacement on their properties.

¶9 The PSC concluded that "the general public interest and future uses of ratepayer generated dollars are best served by denying applicant's request for a 5.5 cent per hundred cubic feet of water surcharge on water sales."

¶10 The City appealed the PSC's decision to the circuit court under WIS. STAT. ch. 227 (1999-2000),[1] contending that the PSC's denial of the rate increase was arbitrary and capricious and not founded upon proper legal standards. The circuit court agreed and reversed. It concluded that the PSC's interpretation of WIS. STAT. ch. 196 was clearly contrary to legislative intent and otherwise unreasonable and without rational basis.

DISCUSSION

¶11 In deciding an appeal from a circuit court's order affirming or reversing an administrative agency's decision, we review the decision of the agency, not that of the circuit court. ***Wisconsin Prof'l Police Ass'n v. PSC***, 205

[1] All references to the Wisconsin Statutes are to the 1999-2000 version unless otherwise noted.

Wis. 2d 60, 66-67, 555 N.W.2d 179 (Ct. App. 1996). The PSC is charged with supervising and regulating public utilities. WIS. STAT. § 196.02(1). The rates of public utilities must be "reasonable and just." WIS. STAT. § 196.03(1). Public utilities must file a schedule of their rates with the PSC, WIS. STAT. § 196.19(1), and they must charge according to those filed schedules. WIS. STAT. § 196.22. Public utilities must obtain PSC approval for any change in the scheduled rates. WIS. STAT. § 196.20(1). If the PSC finds that a rate is "unjust, unreasonable, … or unjustly discriminatory or preferential" it "shall determine and order reasonable rates." WIS. STAT. § 196.37(1). Because these sections charge the PSC with determining "reasonable" and "just" rates, they confer substantial discretion on the PSC. ***Wisconsin Cent. Ltd. v. PSC***, 170 Wis. 2d 558, 568, 490 N.W.2d 27 (Ct. App. 1992) (deciding WIS. STAT. § 196.04(4), charging the PSC with prescribing terms and compensation that are "equitable and reasonable," confers substantial discretion to the PSC). Indeed in rate-setting cases generally, the PSC acts under standards that confer substantial discretionary authority. *See* WIS. STAT. § 227.01(3)(a) (proceedings in which an agency acts under a substantial amount of discretion include rate making proceedings); *see also* ***Madison Gas & Elec. Co. v. PSC***, 109 Wis. 2d 127, 135, 325 N.W.2d 339 (1982) (stating PSC has wide discretion in determining rates).

¶12 The reviewing court may not substitute its judgment for that of the PSC on an issue committed to the PSC's discretion. WIS. STAT. § 227.57(8).[2]

[2] WISCONSIN STAT. § 227.57(8) provides:

(continued)

Rather, review of the PSC's decision is limited to determining whether it was arbitrary or capricious and whether the PSC's findings of fact are supported by substantial evidence in the record. ***Wisconsin Cent. Ltd.***, 170 Wis. 2d at 568. An arbitrary or capricious decision lacks a rational basis and is the result of an unconsidered, willful, or irrational choice rather than a "sifting and winnowing" process. ***Wisconsin Prof'l Police Ass'n***, 205 Wis. 2d at 74. The burden is on the City to demonstrate that the PSC's decision on the rate increase is unreasonable. ***Madison Gas & Elec. Co. v. PSC***, 150 Wis. 2d 186, 189, 441 N.W.2d 311 (Ct. App. 1989).[3]

¶13 The City first argues that the PSC's decision does not have a rational basis because it is not reasonable that the utility customers with lead laterals bear the entire cost of regulatory compliance. The City contends that all utility customers will benefit from the lead replacement program: fines up to $25,000 per day will be imposed on the utility if the City fails to comply with federal

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> (8) The court shall reverse or remand the case to the agency if it finds that the agency's exercise of discretion is outside the range of discretion delegated to the agency by law; is inconsistent with an agency rule, an officially stated agency policy or a prior agency practice, if deviation therefrom is not explained to the satisfaction of the court by the agency; or is otherwise in violation of a constitutional or statutory provision; but the court shall not substitute its judgment for that of the agency on an issue of discretion.

[3] The circuit court viewed the PSC's decision as one interpreting "reasonable" in WIS. STAT. §§ 196.03(1) and 196.37(1), which the court viewed as a question of law. However, when a statute authorizes an agency to act according to a standard of reasonableness and the challenge is that the agency's decision was unreasonable, we are reviewing the agency's exercise of discretion, and we look to WIS. STAT. § 227.57(8) for the scope of our review. *See* ***Wisconsin Cent. Ltd. v. PSC***, 170 Wis. 2d 558, 568, 490 N.W.2d 27 (Ct. App. 1992). We are not reviewing the agency's interpretation of the statutory term "reasonable."

requirements, and the alternative of chemical treatment would be more costly to utility customers and would adversely affect lake vegetation and algae growth.

¶14 While the City presents a rational basis for approving its application, that does not, by itself, mean that the PSC's decision lacks a rational basis. The basis for the PSC decision is that the proposed rate increase would be used to benefit a select group of customers by providing a subsidy for the replacement of the privately-owned lead laterals, which those customers are responsible for maintaining and repairing. The PSC's decision reflects its consideration of the issue of lead reduction and potential penalties for noncompliance with federal regulations. However, it is undisputed that a portion of the lead causing the City's compliance problem is from the laterals of customers who own them and have the responsibility of maintaining them. Thus, it is reasonable for the PSC to view the surcharge as subsidizing a direct benefit to a select group of customers. It is also reasonable for the PSC to view the City's decision to require property owners with lead laterals to replace them as a decision made by local government for the benefit of the public at large, carrying with it the responsibility of the local government to provide for any subsidy it considers to be in the public's interest. The PSC's decision does not prevent the City of Madison from choosing the replacement program as the better alternative. Rather, it prevents the City from using the utility rates to fund the subsidy. It may be that all utility customers will benefit from the surcharge in the sense that the result will be in compliance with the EPA levels without the adverse effects of chemical treatment. But all utility customers will receive that same benefit if the customers who own the lead laterals pay for their replacement, or if the City funds a subsidy in some other way.

¶15 The City also contends that its proposal is reasonable because it was part of a local legislative decision made under the City's broad constitutional and

statutory home-rule authority, as well as the City's statutory right to reasonably regulate and manage its public water utility. However, when the City seeks to raise the water rates it is performing a public utility function, not a municipal function, and its municipal powers do not limit the power of the PSC to regulate it as a public utility. ***Hovde v. Village of Waunakee***, 140 Wis. 2d 487, 493, 411 N.W.2d 423 (Ct. App. 1987).

¶16 Finally, the City argues that the PSC's decision relies on the unsupported assumption that some of the lead laterals "could be in need of replacement in the not too distant future" and "the owners of the properties in the Isthmus/Capitol area knew or should have known of the lead lateral liability and of the potential need for lateral replacement on their properties." Although the City concedes that the PSC's findings that are labeled "Findings of Fact" are supported by substantial evidence, the City is apparently contending that these two statements in the PSC's opinion are also findings of fact, and therefore must be supported by substantial evidence. We agree that if the PSC's decision depends upon any facts in these two statements of fact, they must be supported by substantial evidence even if they are not labeled "Findings of Fact." *See* WIS. STAT. § 227.57(6).[4] A finding, or statement, of fact is supported by substantial

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[4] WISCONSIN STAT. § 227.57(6) provides:

> (6) If the agency's action depends on any fact found by the agency in a contested case proceeding, the court shall not substitute its judgment for that of the agency as to the weight of the evidence on any disputed finding of fact. The court shall, however, set aside agency action or remand the case to the agency *if it finds that the agency's action depends on any finding of fact that is not supported by substantial evidence in the record*.

(Emphasis added.)

evidence if, taking into account all the evidence in the record, a reasonable mind could make the same finding as did the agency. ***Madison Gas & Elec. Co.***, 150 Wis. 2d at 191. Factual findings include the drawing of one of several reasonable inferences from undisputed facts. ***Michels Pipeline Constr., Inc. v. LIRC***, 197 Wis. 2d 927, 931, 541 N.W.2d 241 (Ct. App. 1995). We therefore examine the two statements cited by the City to determine whether the PSC decision depends upon any facts contained in these statements, and, if so, to determine whether those findings of fact are supported by the record. We do so by considering the statements in the context of the entire paragraph, which we have quoted in ¶8 of this decision.

¶17 Regarding the PSC's statement that "[w]hile many [laterals] may have practical service life remaining, others could be in need of replacement in the not too distant future," it is undisputed that the lead laterals were last installed in 1927, and that of the 11,000 customers who originally had lead laterals, an estimated 2,100 customers have replaced theirs.[5] It is reasonable to infer from these facts that some number of the remaining customer-side lead laterals would be replaced within the next ten years even if the City did not require it, and that the replacement would be paid for by the customers who own the laterals. The PSC's decision does not depend upon all or any particular number of customer-side lead laterals needing replacement even if the City did not require replacement. The PSC's point is simply that the proposed rate increase would be subsidizing replacement costs for some customers who would be voluntarily making

[5] The City does not dispute the PSC's statement that "the [utility's] depreciable life for laterals is 60 years." However, we have not been able to locate any evidence of this in the record, and we therefore do not rely on it in our analysis.

replacements and paying for them anyway, and this is supported by substantial evidence.

¶18 Regarding the PSC's statement that "[i]t is reasonable to assume that the owners of the properties in the Isthmus/Capitol area knew or should have known of the lead lateral liability and of the potential need for lateral replacement on their properties," we must read this in conjunction with the preceding sentence: "In Madison, as in most if not all other Wisconsin municipalities, it is the property owner who is responsible for the repair and ultimate replacement of the customer portion of the lateral." The customers' actual knowledge, or their opportunity for knowledge, of the need to replace lead laterals is not the point of the challenged statement, nor is that knowledge critical to the PSC's decision that the rate increase is not reasonable. Rather, the point the PSC is making here is that the owners of the lead laterals had no reason to expect that anyone else would pay for any replacement, and this is supported by substantial evidence.

¶19 Essentially, the City is asking us to decide that its proposal is reasonable. However, we are to review for reasonableness the decision the PSC did make, not a decision it did not make. We conclude the decision of the PSC is reasonable and is supported by substantial evidence. Therefore, we reverse the order of the circuit court and direct that it enter an order affirming the PSC's

decision denying the City's application for a rate increase of 5.5 cents per hundred cubic feet of water.[6]

By the Court.—Order reversed.

Recommended for publication in the official reports.

[6] The City also argues that the PSC has not distinguished this reimbursement program from other programs supported by utility user revenues such as: the water utility bill adjustments when the utility requests a customer to let water flow to prevent freezing of service laterals, WIS. ADMIN. CODE § PSC 185.35(7); mandatory chemical treatment for lead corrosion control in other public water utility systems, WIS. ADMIN. CODE § PSC 185.81(1); or low income energy assistance or conservation assistance programs, which mandate low income assistance and energy conservation and efficiency be funded by public benefits fees charged to all customers, WIS. STAT. § 16.957. However, beyond making this assertion, the City does not provide any details about these programs nor develop an argument directed at why the existence of those programs demonstrates the PSC's decision is unreasonable. We therefore do not consider this argument. *See* ***Fritz v. McGrath***, 146 Wis. 2d 681, 686, 431 N.W.2d 751 (Ct. App. 1988).