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STATE OF FLORIDA

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JACK SHREVE
PUBLIC COUNSEL

July 29, 1998

Blanca S. Bayo, Director
Division of Records and Reporting
Florida Public Service Commission
2540 Shumard Oak Blvd.
Tallahassee, FL 32399-0850

Re: Docket No. 971663-WS

Dear Ms. Bayo:

Enclosed for filing in the above-referenced docket are the original and 15 copies of Citizens' Memorandum of Law in Support of Citizens' Motion to Dismiss. A diskette in WordPerfect 6.1 is also submitted.

Please indicate the time and date of receipt on the enclosed duplicate of this letter and return it to our office.

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Sincerely,

Harold McLean
Associate Public Counsel

HM:bsr

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BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In Re: In re: Petition of Florida Cities Water Company for limited proceeding to recover environmental litigation costs for North and South Ft. Myers Divisions in Lee County and Barefoot Bay Division in Brevard County.	DOCKET NO. 971663-WS Filed: July 29, 1998

MEMORANDUM OF LAW IN SUPPORT OF CITIZENS' MOTION TO DISMISS

The Citizens of the State of Florida, by and through JACK SHREVE, Public Counsel, (Citizens) file this their Memorandum of Law in Support of Citizens' Motion to Dismiss, the Motion to Dismiss against Florida Cities Water Company (FCWC) having been filed by the Citizens on July 10, 1998.

Alleged facts taken as true

The Citizens recognize that its Motion to Dismiss entitles the Commission to take the facts alleged by FCWC as true for purposes of the motion. In evaluating a motion to dismiss, the Commission should confine its consideration to the four corners of the complaint and must accept all well-pleaded allegations as true. See, e.g., Abrams v. General Ins. Co., 460 So.2d 572 (Fla. 3d DCA 1984); Jones v. Kirkland, 696 So.2d 1249 (Fla. 4th DCA 1997).

Among the various allegations of FCWC's petition which must be taken as true for purposes of this motion, show that the litigation expenses sought in this action were incurred for services rendered form 1992 through 1997, and that the litigation expenses were recorded below

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the line for those periods.[1] The Citizens say that the allegations of the petition, when taken as true, do not make out a case upon which relief can be based. Because the Commission may not engage in retroactive ratemaking, the petition seeks reimbursement for expenses incurred in the past. Moreover, the Citizens' Motion to Dismiss also addresses the necessity of FCWC's alleging that their existing rates do not provide a fair rate of return. This memorandum of law will address only the first half of the Motion, namely that portion directed to retroactive ratemaking.

The Commission may not engage in retroactive ratemaking

The Commission has consistently recognized that it may not engage in retroactive ratemaking. The courts have approved the Commission's forbearance, and have occasionally ordered it. The Citizens believe they have provided adequate legal authority to support their Motion to Dismiss in the motion itself, but here tender additional legal authority.[2]

Federal and state authorities have long recognized the prohibition against retroactive ratemaking. In Columbia Gas Transmission Corporation v. Federal Energy Regulatory Commission, 831 F. 2d 1135 the United States Court of Appeals, District of Columbia Circuit said,

> Petitioners challenge Federal Energy Regulatory Commission orders permitting five pipelines to recover a surcharge from their customers on gas already sold to them. The amount of the surcharge would, in effect, reimburse the pipelines for

[1] FCWC's evidence shows that the expenses were booked in the years 1992 through 1996.

[2] The Citizens argued that the following cases recognize the prohibition against retroactive ratemaking: In Re: Application of Ortega Utility Company 95 F.P.S.C. 11:247 (1995); City of Miami v. Florida Public Service Commission, 208 So.2d 249 (Fla. 1968); Gulf Power Co. V. Cresse, 410 So. 2d 492 (Fla. 1982); Citizens of the State of Florida v. Florida Public Service Commission, 448 So.2d 1024 (Fla. 1984); and, GTE Florida Inc. v. Clark, 668 So.2d 971 (Fla. 1996)

the amounts that the pipelines had subsequently been required to pay to producers for certain deferred production-associated costs. The principal issue in these cases is the propriety, under the governing statutes, of such a surcharge.

We conclude that the Commission exceeded its authority when, without proper notice, it approved what in effect were retroactive increases in the price of natural gas previously sold by the pipelines to their customers.

* * *

We have recently had occasion to explain, in the case of electrical utilities, the rationale for prohibiting retroactive increases in filed rates:

> The wholesale purchasers of electricity cannot plan their activities unless they know the cost of what they are receiving, particularly if they are retailers, who must calculate their appropriate resale rates, ... but also if they are large-scale purchaser-users. Providing the necessary predictability is the whole purpose of the well established "filed rate" doctrine, which "forbids a regulated entity to charge rates for its services other than those properly filed with the appropriate federal regulatory authority."

Electrical Dist. No. 1 v. FERC, 774 F.2d 490, 493 (D.C.Cir.1985) (quoting Arkansas Louisiana Gas Co. v. Hall, 453 U.S. 571, 577, 101 S.Ct. 2925, 2930, 69 L.Ed.2d 856 (1981)). Although FERC claims that "Order Nos. 94 and 94-A gave notice that the prices paid for gas during the pendency of the Commission's rulemaking were not final prices," Brief for Commission at 16, the orders were explicitly concerned with first sales. Furthermore, even in that context, the Commission was careful to limit the application of Order No. 94-A to those cases in which first purchasers were contractually bound to pay the deferred costs.

As a general matter, the final rules will not operate to authorize the collection of amounts for production-related costs incurred prior to today. *A basic principle of administrative procedure is that rules should operate prospectively only.* We see no reason to depart from this principle in implementing these

amendments. To the contrary, there is good reason to adhere to it. (Italics supplied)

48 Fed.Reg. at 5,161.

831 F. 2d at 1141

Thus it is recognized in the federal system, for both natural gas transmission and wholesale sales of electrical energy under the FERC, that retroactive ratemaking is prohibited. The attempt of the five natural gas pipelines to recover amounts that the pipelines had subsequently been required to pay to producers for certain deferred production-associated costs, is analogous to FCWC's attempt to charge noone for expenses incurred in the past. Although it maybe said that the FCWC petition charges prospectively, not retroactively, the same might be said of the five pipelines in Columbia. In Columbia, the surcharge would have been levied in advance of its collection - yet it failed upon retroactive ratemaking scrutiny because it was based upon expenses foregone by the pipelines in the past. Thus it is with FCWC's petition and with the unsuccessful petition in Ortega which is discussed in the Citizens' Motion.[3] The Commission recognized that although the Ortega rates were to be charged - if approved - in the future, this was an attempt to recover expenses incurred in the past. What FCWC seeks here has been rejected by both the Commission and the Federal Appellate Courts.

The Division of Administrative Hearings (DOAH), has similarly applied the prohibition against retroactive ratemaking. In an application for a rate increase, of Seminole Utility Company, heard by DOAH in September, 1980, the utility ran afoul of the prohibition by

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[3] Ortega Utility Company attempted to collect allegedly foregone depreciation expense in rates to be charged retrospectively.

establishing its interim rates with retroactive effect. It was alleged by the utility - as it is here alleged by FCWC - that their action was undertaken in good faith. In that case the hearing officer said:

> However innocently imposed, the Utility's action constitutes improper retroactive ratemaking. The utility should refund to customers of record during the period in question their pro-rata share of revenues collected by the retroactive rate increase.

The recommended order was accepted by the commission in all relevant part. See, In Re: Application of Seminole Utility Co. 81 F.P.S.C. 1:221 (1980).

In a later DOAH case, the examiner's recommendation recognizing the prohibition against retroactive ratemaking was also adopted by the commission . In Commission docket In re Application of Century Utilities Inc., 82 F.P.S.C. 3:54 (1982) the utility determined that it had used an incorrect depreciation rate in the past, and attempted to retroactively apply the 'correct' depreciation rate. The DOAH hearing examiner rejected the attempt and the Commission adopted the DOAH order on the point. The Commission order provides:

> The petitioner contends that the 2.5% annual depreciation rate should be retroactively applied because the change is the result of a "correction of an error" rather than a "change in accounting estimate" . . .
>
> * * *
>
> The examples given in APB Opinion No. 20, paragraphs .10 and .13, to distinguish an error from a change in estimate lead the undersigned to conclude that a change in projected lifespan of an asset, for depreciation purposes, is a change in estimate requiring prospective application only.
>
> * * *
>
> It is concluded that the 6% deprecation rate should apply from 1969 through the 1979 test year and that the 2.5% rate should apply from that date forward.

82 F.P.S.C. 3: at p. 59

The hearing officer's conclusions were expressly adopted by the Commission.

The prohibition against retroactive ratemaking has occasionally been urged before the Commission by regulated utilities. On May 1, 1979, after hearing, the Commission set certain revenue of United Telephone Company of Florida (United) subject to refund, pending further regulatory proceedings. After a comprehensive ratemaking proceeding, the Commission increased United's authorized rate of return, but nonetheless found that the Company's revenue provided a return in excess of its newly authorized rate, and ordered United to make a refund effective from May 1, 1979. Over United's (and intervenor Southern Bell's) retroactive ratemaking objections, the Court in United Telephone Company of Florida v. Mann, 403 So.2d. 962 (Fla 1981), found that the interim statute which permitted the Commission to establish interim rates contingent upon the outcome of the full hearing, permitted it to do so irrespective of whether the comprehensive proceeding resulted in an increased revenue or decreased revenue requirement for the applicant. Thus the prohibition against retroactive ratemaking was argued, albeit, unsuccessfully by both United and Southern Bell Telephone and Telegraph Companies. The court implicitly recognizes the prohibition, however, when it holds:

> We therefore hold that the commission has the discretion to determine that amount of revenues collected during the interim period which are excessive *so long as that amount does not exceed the amount ordered subject to refund at the interim hearing.* (Italics supplied)

403 So.2d at 968

It is reasonable to infer that the court would have declined to permit any finding by the commission that a refund should exceed the sums held subject to refund. Thus the United case recognizes the prohibition against retroactive ratemaking, even though the prohibition did not work to overturn a Commission order which provided for an interim refund.

In Southern Bell Telephone and Telegraph Company v. Florida Public Service Commission, 780 So.2d 453 (Fla. 1984) the Florida supreme court again recognized the prohibition against retroactive ratemaking, again as the doctrine was urged by a regulated utility. In Bell, a dispute arose between Southern Bell Telephone and Telegraph Company (Bell) on the one hand, and General Telephone Co. of Florida (General) on the other, in the separations and settlement process; a dispute over which the Commission had jurisdiction. While the facts of separation and settlements disputes are less than compelling reading from virtually any point of view, it should suffice to say that the point of contention between Bell and General revolved around whether the Commission had jurisdiction to decide such a case, and if the Commission did have jurisdiction to decide the case, from what point in time should a remedy be had. Relevant here, is the Court's pronouncements regarding retroactive ratemaking:

> We believe that the statutory authority to adjudicate such disputes is properly related to the Commission's essential function as regulator of the rates and service of utilities. *However, we believe that any such adjudicatoin must be given prospective effect only. To hold otherwise would violate the principle against retroactive ratemaking.* See City of Miami v. Flroida Public Service Commission, 208 So2d 249 (Fla. 1968) (Italics supplied)

453 So.2d at 784

The case which apparently attracted the attention of Ortega Utility Company in its attempt to convert alleged depreciation, allegedly forgone, to a regulatory asset is Citizens of the State of Florida v. Florida Public Service Commission, 415 So.2d 1268 (Fla 1982). (A case which involved the petition of Southern Bell Telephone and Telegraph Company) While the supreme court cerainly recognized the prohibition against retroactive ratemaking, it summarily contrasted represcription of deprecation on the one hand with ratemaking on the other. It said:

> We find that Public Counsel's reliance on section 364.14 and City of Miami is misplaced because tht section and case concern rate-making. Under the present facts, the PSC was not ratemaking but rather, was considering depreciation represcription.

415 So.2d at 1270

FCWC's petition makes no claim regarding represcription of depreciation: the commission is being asked to engage in conventional ratemaking, in which the prohibition against retroactive ratemaking is applicable.

Academic authorites advance the prohibition against retroactive ratemaking. Professor A.J. G. Priest has addressed the topic as follows:

> It has been long established that past deficits may not be made the predicate for striking down rates which are otherwise compensatory, "any more than past profits can be used to sustain confiscatory rates for the future. But extraordinary losses occasioned by obsolescence not covered through depreciation accruals occupy a distinct and separate niche. (Footnote omitted)

A. J. G. Priest, Principles of Public Utility Regulation, the Michie Company (1969), Vol. 1, p. 75

It is interesting that Professor Priest recognizes the depreciation niche addressed in the Bell depreciation case. But the niche notwithstanding, Professor Priest specifically addresses the

prohibition and notes the elegantly simple reason for the prohibition: the Commission cannot bring deficits forward anymore than it can bring forward past profits. In other words, had FCWC enjoyed a windfall in the years 1992 through 1997, future compensatory rates could not be lessened by taking account of past profits. Ratemaking authority runs prospecitively, not retroactively.

Similarly, Professor Bonbright, in his Principles of Public Utility Rates, 2d Ed. (1988) Public Utilities Reports, Inc. notes, almost en passant:

> Nor as a general rule of ratemaking will a utility be allowed to set rates to recover past losses. Commissions are generally proscribed from fixing retroactive rates, although some jurisdictions allow the recovery of past fuel rates through surchages to present rates. (Citations omitted)

Bonbright at 198

The fuel adjustment matter is recognized in Floirda law. The supreme court in Gulf Power Company v. Florida Public Service Commission, 487 So.2d 1036 (Fla. 1986) held:

> [3] Nor do we find that the order constitutes prohibited retroactive ratemaking fuel adjustment. Fuel adjustment charges are authorized to compensate for utilities' fluctuating fuel expenses. The fuel adjustment proceeding is a continuous proceeding and operates to a utility's benefit by eliminating regulatory lag. This authorization to collect fuel costs close to the time they are incurred should not be used to divest the commission of the jurisdiction and power to review the prudence of these costs. The order was predicated on adjustments for 1980, 1981, and 1982. We find them to be permissible.

487 So.2d at 1037

Fuel adjustment aside, Professor Bonbright recognizes a general rule of ratemaking that past losses may not be recovered in future rates. FCWC's petition is an attempt to recover

expenses which might have lead to losses and which could not be recognized in this case because they are from a prior period. As is argued by the Citizens in the instant motion, FCWC never alleged that the expenses caused the company to earn outside its authorized rate of return, and should be denied on that basis alone.

Conclusion:

The prohibition against retroactive ratemaking is virtually universally recognized. Florida courts recognize it and enforce it, DOHA recognizes it and enforces it, federal courts recognize it and enforce it, and most importantly, this commission has consistently recognized it and enforced it. Ratemaking is fundamentally a prospective remedy. Irrespective of the extent to which this commission finds that a utility is over earning, it may do nothing until such time as it formally subjects money to refund: it may not reach monies prior to that time irrespective of how compelling the circumstances may be. Expenses foregone by a utility, such as FCWC, irrespectively how prudently incurred, may not be recovered retrospectively any more than excess profits can.

Respectfully Submitted,

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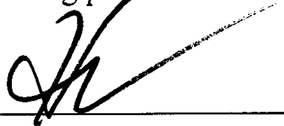
Attorney for the Citizens of the
State of Florida

CERTIFICATE OF SERVICE

I certify that a true copy of the foregoing Memorandum of Law in Support of Citizens' Motion to Dismiss was served by United States Mail, or where the party is denoted by an asterisk (*) by hand delivery upon representatives of the following parties on this the 29th day of July, 1998.



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