orig.

IN THE SUPREME COURT OF FLORIDA

THE CITIZENS OF THE STATE OF FLORIDA,

Petitioners/Appellants,

vs.

FLORIDA PUBLIC SERVICE COMMISSION,

Respondent/Appellee,

and

JACKSONVILLE SUBURBAN UTILITIES CORPORATION and SOUTHERN UTILITIES COMPANY,

Respondents/Appellees.

CASE NO. 64,680

APPEAL FROM DECISION RENDERED BY THE DISTRICT COURT OF APPEAL FOR THE FIRST DISTRICT OF FLORIDA IN CASE NO. AE-103

ANSWER BRIEF OF RESPONDENTS/APPELLEES, JACKSONVILLE SUBURBAN UTILITIES CORPORATION AND SOUTHERN UTILITIES COMPANY, IN RESPONSE TO POINT II RAISED BY THE FLORIDA PUBLIC SERVICE COMMISSION IN ITS BRIEF ON THE MERITS

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SYMBOLS AND DESIGNATION OF PARTIES

Petitioners/Appellants, the Citizens of the State of Florida, are referred to as "Public Counsel."

Respondent/Appellees, Jacksonville Suburban Utilities Corporation and Southern Utilities Company, are referred to, respectively, as "Suburban" and "Southern," or collectively as the "Utility."

Respondent/Appellee, the Florida Public Service Commission, is referred to by that name or as the "Commission."

The First District Court of Appeal is referred to as the "First District."

References to Respondent's Brief on the Merits, filed with this Court by the Commission, are indicated by "Commission's Brief, p. ____" followed by the appropriate page number(s).

Volumes I through VI of the record contain the pleadings, motions and memoranda filed in the proceeding before the Commission. References to Volumes I through VI of the record are designated by the letter "R" followed by the appropriate page number(s), e.g., "R:1."

Volumes VII through IX of the record contain the transcripts of the hearings before the Commission. References to the transcripts of testimony are indicated by the letter "T" followed by the appropriate page number(s), e.g., "T:101."

Volumes X through XII of the record contain exhibits numbered J-1 through S-25 filed below. Exhibits are designated by "Ex." followed by the appropriate exhibit number(s), e.g., "Ex. J/S-7."

STATEMENT OF THE CASE AND OF THE FACTS

The Utility does not disagree with the statement of the case contained in the Statement of the Case and of the Facts included in the Commission's Brief. However, that portion of the Commission's statement concerning the attrition allowance issue is incomplete. Therefore, the Utility files the following Statement of the Facts separately with regard to Point II raised by the Commission [Commission's Brief, pp. 10-22]:

Statement of the Facts

In its Applications to the Commission, the Utility requested the allowance of additional operating expenses to include an allowance for attrition caused by inflation, in the amounts of $38,649 for Suburban's water operations and $98,817 for its sewer operations, and $31,617 for Southern's water operations and $89,052 for its sewer operations [Ex. J-4 and S-4, Supplementary Schedule 1 to FPSC 2h; infra, pp. A-1 through A-4]. The Utility presented extensive testimony stating that the purpose of the requested allowance was to offset the erosion in the Utility's rate of return caused by inflation [T:224-225, 228-232].

The allowance requested by the Utility was proposed by its expert witness, Mr. John Guastella, a utility consultant and former director of the Water Division of the New York Public Service Commission. Mr. Guastella previously had testified before the Commission, at its invitation, in a workshop to develop information concerning the treatment of CIAC in water and sewer utility rate cases (Commission Docket No. 770722-WS) [Ex. J/S-7, p. 3]. At that workshop, he suggested the use of forward-looking ratemaking

techniques as a means of protecting utilities in times of increasing costs [T:233].

In the proceeding before the Commission below, Mr. Guastella testified that:

> An analysis of individual expense categories will show that some expenses will increase or decrease due to changes in unit costs and/or quantities of usage. For example, purchased power costs will increase according to increases in electric rates as well as increases in electric energy consumption and demand. Adjustments for such increases are of course necessary to keep pace with inflation, and are routinely recognized and allowed by regulatory agencies throughout the country in cases where the increased electric rates are known.
>
> However, in order to set rates at levels necessary to cover the prospective costs of providing service -- costs which must be covered if the utility is to have a realistic opportunity to earn the allowed rate of return -- then allowances for costs must be based on the increases reasonably expected during the year the new rates will be in effect.
>
> And if some or all of those costs must be estimated, then the estimate must be made and used.
>
> * * *
>
> . . . [I]f no increase to a particular expense is allowed because the precise amount of the increase is not yet known, then what the regulatory agency is in effect saying is that its best estimate of the increase in that expense is zero. To use "zero" as an increase, when there is absolute certainty that something greater than a zero increase will occur, is to knowingly base rates on costs which are understated and will surely prevent a utility from earning the allowed rate of return. [Ex. J/S-7, pp. 10-11.]

With regard to the present case, Mr. Guastella further testified:

> . . . the advice I gave the people preparing the Company's rate filing was to determine the most reasonable estimate of the level of each expense for the year the rates are expected to be in effect. In some instances, percentage increases in certain costs could

> be determined with relatively good precision. In other instances, costs would increase at a rate reasonably in line with the general inflation rate and should be so adjusted.
>
> Of course, the revenues must also be adjusted to the level expected during the first year the new rates will be in effect. [Ex. J/S-7, p. 12.]

In the present case, the Utility requested revenue sufficient to allow recovery of the expenses that would be incurred during the future period for which the Commission was setting rates (the first 12 months after the new rates were to become effective). The record below contains extensive testimony that, during inflationary periods, setting rates solely on the basis of historical costs, even if adjusted for the most recent costs, would not provide the Utility with a realistic opportunity to earn the rate of return allowed by the Commission [Ex. J/S-7, pp. 6-7]. Public Counsel's witness, Mr. David Parcell, agreed that in order to avoid attrition, the rates must be sufficient to cover the expenses that would be incurred during the period for which the rates were set [T:578]. Mr. Guastella further testified that, where rates do not provide for the effects of inflation, the resulting inadequate earnings of the Utility will cause the Utility to pay higher interest rates to attract capital than would have been necessary had the Utility earned the rate of return allowed by the Commission [Ex. J/S-7, pp. 6-7]. A higher cost of capital obviously would be contrary to the best interests of the ratepayer [Ex. J/S-7, p. 7]. Mr. Guastella also testified that the New York Public Service Commission had dealt with the problems caused by inflation through use of several methods, including requiring all utilities to file, as a part of their rate adjustment applications, data for a projected test year, using an historical test year only as a period from which to base projections [Ex. J/S-7, p. 9].

In the present proceeding before the Commission, Mr. Guastella recommended that the Utility analyze each individual expense in order to determine whether that particular expense could reasonably be expected to increase or decrease during the first year the new rates would be in effect [Ex. J/S-7, pp. 10-11]. In cooperation with the consultant, Mr. Guastella, the Utility's personnel determined the most reasonable estimate of the level of each expense for the first year the rates were expected to be in effect, after giving effect to customer growth [T:289]. Many of the increases that would affect the various expenses during the ensuing 12-month period were already known and, therefore, were capable of being projected with great accuracy [T:240-242, 283]. Where increases in certain costs could not be determined with relative precision, those costs were projected to increase at a seven percent (7%) annual rate. The inflation rate proposed was conservative, lower than the increases permitted by the Presidential Guidelines then in effect, and substantially below the general inflation rate actually experienced [Ex. J/S-7, pp. 11-12; T:269-271].

In support of the requested allowance, Mr. Guastella testified that the Utility's proposed allowance was a more accurate and conservative allowance than the more traditional attrition allowance computed as a blanket adjustment in the rate of return. He further testified that, by reviewing each expense separately and applying a conservative inflation adjustment for each expense, the Utility and the Commission could better analyze the sufficiency of the requested allowance [T:233-234]. Mr. Guastella concluded that, in his expert opinion, without the provision of some allowance for erosion of earnings, the Utility would not earn its allowed rate of return even during the first year the rates were to be in effect [T:247].

Despite the fact that no party introduced testimony or other evidence contradicting Mr. Guastella's expert testimony, the Commission denied the four separate amounts comprising the requested allowance (one for each of the component companies' water and sewer operations) on the ground that "the utility has failed to present competent substantial evidence to support the allowance." Order No. 9533, at Page Twenty-Two [R:842]; id., at Pages Forty, Forty-Three, Fifty-Two and Fifty-Four [infra, pp. A-5 through A-8].

The record evidence shows that the Utility failed to earn its allowed rate of return for each of the years from 1974 through 1978 [Ex. J/S-7, at pp. 15-16; infra, pp. A-9 and A-10; T:253].

ARGUMENT IN RESPONSE TO POINT II RAISED BY THE COMMISSION IN ITS BRIEF

THE INFLATION-ATTRITION ALLOWANCE REQUESTED BY THE UTILITY IS SUPPORTED BY THE COMPETENT AND SUBSTANTIAL EVIDENCE IN THE RECORD, AND THEREFORE THE DECISION OF THE FIRST DISTRICT BELOW SHOULD BE AFFIRMED.

INTRODUCTION

In this case, the Utility requested an "attrition allowance" to offset the impact of inflation on the Utility's operations. This allowance was intended to permit the Utility to recover from its customers expenses based on the historic expenses for the test year ended September 30, 1978, as adjusted (i) for pro-forma expenses that were fixed and known at the time that the Utility prepared its exhibits and (ii) by an "attrition allowance" or "inflation factor" to offset the impact of inflation during the 12-month period immediately after the new rates were to be placed into effect.

Although all parties to these proceedings repeatedly have described this latter adjustment as an "attrition allowance," it is not, nor was it intended to be, a true attrition allowance as that term traditionally has been used in Commission proceedings or in regulatory parlance. Traditionally, an "attrition allowance" is computed as an adjustment in the rate of return. In the present case, the requested allowance was calculated by increasing certain operation and maintenance expenses by a reasonable "inflation factor." In concept, the adjustment proposed by the Utility below is virtually identical to the indexing procedure adopted by the 1980 Florida Legislature in its amendment to Section 367.081, Florida Statutes (1980 Supp.) [Chapter 80-99, Section 10, Laws of Fla.]. Therefore, the requested adjustment could more

accurately be described as an "inflation allowance" or an "inflation-attrition allowance," as the First District did in its opinion below [The Citizens of the State of Florida v. Florida Public Service Commission (Jacksonville Suburban), 440 So.2d 371, 372 (Fla. 1st DCA 1983)]. As such, the requested allowance provides only a portion of the relief available from the more traditional attrition allowance. For convenience, however, this adjustment sought by the Utility has been, and herein sometimes will be, referred to as an "attrition allowance."

The Commission found below that "the attrition allowance should be denied because the utility has failed to present competent substantial evidence to support the allowance." Order No. 9533, at Page Twenty-Two [R:842]. Upon the Utility's Petition for Rehearing, the Commission reviewed this denial, and concluded that it "remain[ed] convinced of the correctness of [its] denial of the attrition allowance." Order No. 10007, at Sheet No. 1. A review of the record clearly establishes, however, that it contains ample competent and substantial evidence to support the award of an attrition allowance, and the First District so found in its opinion below [Jacksonville Suburban, supra, at p. 372]. It appears, therefore, that the allowance was denied by the Commission solely on the arbitrary ground that it was not in the traditional form utilized by the Commission in other rate proceedings. This arbitrary denial of the requested allowance by the Commission resulted, in effect, in the allowance of a zero percent (0%) inflation factor. As a result, it constituted an abuse of the Commission's discretion, and the First District correctly ordered the remand of Order No. 9533 to the Commission for determination of a proper inflation allowance.

I.

AN INFLATION-ATTRITION FACTOR MUST BE CONSIDERED IN SETTING RATES FOR FUTURE PERIODS.

One of the most difficult ratemaking problems faced by any regulatory commission in periods of continuing inflation is how to determine what expenses a given utility will incur in the future period during which newly set rates will be in effect. As a leading commentator so aptly stated, during an era in which inflation was a less pressing concern than it has been since the beginning of the Utility's test year in the present case:

> Inflation seems to be another economic fact of life from which neither public utilities nor their customers can escape.
>
> . . . Agencies to whom this legislative [ratemaking] power has been delegated are free, within the ambit of their statutory authority, to make the pragmatic adjustments which may be called for by particular circumstances. Pragmatic adjustments seem called for now by steadily expanding price levels. They certainly will be demanded by still further inflation. [A.J.G. Priest, Principles of Public Utility Regulation (Charlottesville, Virginia: The Michie Co., 1969), v. 1, p. 171; emphasis added; footnotes omitted.]

Since rates are set for the future, if a public service commission does not authorize sufficient revenue, not only to provide for all prudent expenses that will be incurred by the utility in the future period, but also to provide for the constitutionally mandated fair return to the utility, the utility's financial condition and ability to provide service could be placed in jeopardy.

The Commission itself has described the process of determining future expenses as follows:

> In regulatory rate making, it is customary to select a test year or period for the purpose of testing the revenue requirements of the utility under consideration. The judicial decisions on the subject of the appropriate test year in a utility rate case uniformly adhere to the rule that the test period should be based on the utility's most recent actual experience, with such adjustments as will make the test period reflect typical conditions in the immediate future. . . . The propriety of a test year depends upon how well it accomplishes the objective of providing a fair rate of return in the future. Thus, the realistic approach to this issue, since rates are fixed for the future and not for the past, is to use the most recently available data for a 12-month period, adjusted for attrition or known changes which will occur within a reasonable time after the end of the period, so as to fairly represent the future period for which the rates are being fixed. [Re General Telephone Co. of Florida, 34 P.U.R.4th 356, 360 (Fla.P.S.C. 1979); citations omitted.]

Moreover, the 1980 Florida Legislature affirmed and emphasized the "forward-looking" ratemaking function of the Florida Commission when it required the Commission, in setting rates, to

> determine the prudent cost of providing service during the period of time the rates will be in effect following the entry of a final order relating to the utility's rate request and [the Commission] may use such costs to determine the revenue requirements that will allow the utility to earn a fair rate of return on its rate base. [Ch. 80-99, Section 10(3), Laws of Florida; emphasis added.]

Because the Commission is setting rates for the future, in times of significant inflation the Commission must determine the impact of rising costs on a utility's ability to earn a fair and reasonable rate of return, or, using regulatory terminology, the Commission somehow must measure "attrition." Although the Utility agrees with the Commission that "[i]nflation and attrition are not the same thing" [Commission's Brief, p. 11], as this Court has recognized, attrition "is principally a by-product of inflation."

Citizens of Florida v. Hawkins (Gentel), 356 So.2d 254, 256 (Fla. 1978). Therefore, the difficult task of compensating for the effects of attrition in setting rates must take inflationary factors into account.

The effect of inflation on the accurate measure of future attrition in setting rates for the future has been described by the Commission as follows:

> [T]he quantification of future attrition can be nothing more than informed judgement [sic] on the part of the person attempting to predict this occurrence. As a matter of fact, no party has suggested a way or means by which to accurately predict future attrition. However, as long as inflation remains a part of our economy, the phenomenon of attrition will continue to occur. This is an indisputable fact of life. No one questions the fact that attrition (or accretion) occurs, and that it affects public utilities. . . . The evidence herein reflects it has occurred for a number of years and has resulted in [the utility's] failing to achieve its authorized rate of return. There are no simple answers or solutions to the problem. However, the fact that future attrition is difficult to measure should in no way deter us from attempting to provide some reasonable solution to the historical effects of earnings erosion. [Order No. 7669, quoted in Re General Telephone Co. of Florida, supra, at pp. 372-373.]

In the past, the Commission utilized numerous ratemaking techniques to combat the effects of attrition, including the use of a year-end rate base, disapproved by this Court in the Gentel case, supra; adjustments to operating expenses for known and measurable changes subsequent to the test period; and, in the case of water and sewer utility companies, an allowance of depreciation on contributed property as an operating expense. However, the Commission subsequently moved to combine the various methods of combating attrition into a single "attrition allowance" in response to this Court's mandate that:

> [A] separate attrition allowance is the appropriate tool. For one thing, attrition is more easily quantifiable than growth. . . . In future rate cases . . . these uncertainties will be eliminated by . . . requiring all adjustments for attrition to be

encompassed within a separate allowance. [Gentel, supra, at p. 258.]

This review of the historical methods of dealing with attrition is important in the present case in order to understand fully the nature of the allowance requested by the Utility. Because it is designed to combat the short-term effects of inflation by adjusting expenses for known and predictable changes, the requested allowance is an integral part of the entire ratemaking process, the goal of which is, as stated by this Court, to reach an "end result" of "rates which are just and reasonable." Jacksonville Gas Corp. v. Florida R.R. & Public Utilities Commission, 50 So.2d 887 (Fla. 1951).

II.

CONFUSION OVER TERMINOLOGY HAS OBSCURED THE NATURE OF THE REQUESTED ALLOWANCE.

The continued reliance placed by the Commission on the formal requirements for the granting of a traditional "attrition allowance" [Commission's Brief, pp. 10-12, 14, 18-21] clearly indicates that the Commission has failed either to understand or to accept the nature of the allowance requested by the Utility. In either case, the approach taken by the Commission has perpetuated the initial confusion concerning the use of the term "attrition allowance." The Commission has requested both the First District and this Court to require evidence sufficient to prove the attributes of a formal attrition allowance. The allowance denied by the Commission, but approved by the First District, is not an "attrition allowance" in the traditional sense, of course, but rather an "inflation-attrition allowance" [Jacksonville Suburban, at p. 372].

The special character of the allowance under consideration here has been recognized by all of the parties from an early stage of the current proceeding. See, for example, the testimony contained in the record at T:285-288, from which the following excerpt is taken:

> THE EXAMINER:
>
> * * *
>
> I thought they [the Utility] were asking for attrition but mathematically computation [sic], the way I have seen it in the past, you take a rate of return, you get all done with that and then you say then what I want is plus 2% attrition. Now in this case you are not asking for that. I understand that.
>
> * * *
>
> I think that what you have done is to take actual expenses that you know of up to today. All your power, all your chemicals, your labor, all the things we have talked about. Now I think what you are asking is as to those [other things] which are unknown, you are adding a mathematical percentage which as far as I'm concerned is a form of attrition, however you want to talk about attrition.
>
> MR. VanNORTWICK: So long as you understand that, Mr. Examiner, that's fine. I am concerned that the use of the term "attrition allowance" was going to carry with it meanings other than which we intended in the testimony.
>
> So long as it is understood that that's all we are trying to do, that's fine. I believe Public Counsel was simply struggling with the fact that traditionally before the Commission attrition allowances and attrition may be something different than the projection of expenses that we are seeking in this case and they are trying to take a round peg and put it in a square hole, so to speak.
>
> * * *
>
> BY MR. BURGESS:
>
> Q If I can go back, Mr. Mullen, to when we were talking about the nature of Mr. Guastella and your joint

effort on preparing the pro forma adjustments, when you were preparing these and Mr. Guastella was aiding you, did he characterize the need for these pro forma adjustments as a need to help offset attrition in future operational years?

A I don't remember him ever characterizing it as an attempt to offset attrition. What he was characterizing it was an attempt to project the expense level that we are going to experience during the first year the rates are in effect.

Q Then the characterization as to the need to offset attrition by the pro forma adjustments is your own?

A That was your question. You asked me about it. You called it attrition. When you talk to me about attrition and characterize it that way, I was addressing what I think Mr. Guastella was addressing as attrition and that was the whole ball of wax. That was the change in revenues, the change in expenses, the change in rate base, the change in earnings.

When you asked me a question and I answered back regarding attrition, that's what I had in mind. If we deal strictly with what I was responsible for in this case, I was strictly responsible for a segment of the increased costs through that first year the rates are in effect.

Q Then if the Commission were to grant the two utilities, Suburban and Southern, a separate allowance to offset anticipated attrition, could you give me any projection of what that amount might be or could you give me what you feel that amount ought to be?

A I think if the Commission was going to come up with a figure for attrition, I presume they would be adding that because they are recognizing a certain amount of inflation and I think what they would be adding it for would be to give the company the opportunity to earn the rate of return that they say is appropriate.

If that's the case, then I think they should be finding the expense number that is being proposed here. . . . [T:285-288.]

The Commission persists, however, in employing analyses based upon an inappropriate and irrelevant use of the "attrition allowance" nomenclature. Once the true nature of the allowance requested by the Utility is recognized, the arguments directed to the alleged shortcomings in the allowance made by the Commission [Commission's Brief, pp. 10-22] can be seen to be unrelated to the type of allowance actually requested. Given the type of inflation allowance requested by the Utility, it is inappropriate and unnecessary to quantify the past impact of attrition, to consider "offsetting economies," or to document the other factors required to support a traditional attrition allowance that are listed by the Commission [Commission's Brief, p. 19].

The Commission argues in its brief that the First District's conclusion that "Utilities met their burden of proving the necessity for an inflation-attrition allowance" [Jacksonville Suburban, p. 372] "demonstrate[s] that the District Court wrongly equated inflation with attrition. . . ." [Commission's Brief, p. 13]. The Commission's analysis is incorrect, however. The First District's use of the term "inflation-attrition allowance" merely evidences its recognition of the special nature of the allowance requested by the Utility. Use of the term does not mean that the First District considered the two concepts to be identical, although even the Commission admits that they often are interrelated [Commission's Brief, p. 11].

The requested allowance is not as novel or unacceptable as the Commission argues, in that the Utility's methodology for computing the attrition allowance is substantially the same methodology adopted by the 1980 Florida Legislature in its amendments to Chapter 367, Florida Statutes, adopted in Chapter 80-99, Section 10, Laws of Florida, wherein the Florida Legislature recognized the wisdom of utilizing an accurate, common-sense approach to

dealing with the problem of inflation.[1] The Legislature did not require each utility to prepare an expensive and time-consuming attrition study to determine if that utility was affected by the impact of inflation. In choosing a single inflation factor of statewide application to Commission-regulated water and sewer utilities, the Legislature recognized the universal impact of inflation and the fact that if each utility were required to undertake an attrition study, the customers would be saddled not only with the burden of inflation, but with the cost of the attrition study as well.

In short, the formal attrition studies and other methods used to quantify traditional "attrition allowances" are inappropriate and irrelevant to the present case, because it is not a traditional attrition allowance that is being requested. To the extent that the Commission's argument is based on the concept that the Utility can recover only for the effects of attrition, not those of inflation, it is arbitrary and must be rejected.

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[1] "On or before March 31 of each year, the commission by order shall establish a price increase or decrease index for major categories of operating costs incurred by utilities subject to its jurisdiction reflecting the percentage of increase or decrease in such costs from the most recent 12-month historical data available. The commission by rule shall establish the procedure to be used in determining such indices and a procedure by which a utility, without further action by the commission, or the commission on its own motion, may implement an increase or decrease in its rates based upon the application of the indices to the amount of the utility's major categories of operating costs incurred during the immediately preceding calendar year, except to the extent of any disallowances or adjustments for those expenses of that utility in its most recent rate proceeding before the commission. The rules shall provide that, upon a finding of good cause, including inadequate service, the commission may order a utility to refrain from implementing a rate increase hereunder unless implemented under a bond or corporate undertaking in the same manner as interim rates may be implemented under s. 367.082. No utility may use this procedure to increase any operating cost for which an adjustment an adjustment has been or could be made under paragraph (b)." Section 367.081(4)(a), Fla. Stat. (1980 Supp.).

III.

CONSIDERATION OF INFLATIONARY FACTORS HAS BEEN APPROVED BY THIS AND OTHER COURTS.

In its brief, the Commission relies in part upon the language contained in footnote 3 to the opinion of this Court rendered in Broward County Traffic Association v. Mayo, 340 So.2d 1152 (Fla. 1976) [Commission's Brief, pp. 14, 20]. That footnote and the accompanying text in Broward County refer to this Court's opinion in Gulf Power Company v. Bevis, 289 So.2d 431 (Fla. 1974), and discuss evidentiary standards for determination of inflation allowances. The Commission apparently cites the Court's footnote in Broward County as proscribing all attempts to give forward-looking consideration to the effects of inflationary factors upon regulated industries.

The Commission's reliance on the footnote in Broward County is misplaced, however. In that case, the Commission, on its own motion and without any evidence in the record, granted an allowance to offset the impact of inflation. In Broward County, this Court simply criticized the inflation allowance as being unrequested by the regulated entity and unsupported by evidence other than the Commission's own "expertise." Understandably, this Court disapproved the "doctrinaire" use of presumed Commission "expertise" to reach "undocumented conclusions as to general economic conditions" unsupported by competent, substantial evidence in the record [Broward County, at p. 1153]. Such a practice is similar in effect to the Commission's selection of the 0% inflation factor in the present case.

What the Commission regards as a blanket prohibition in Broward County is, therefore, not only not such a prohibition, but it is also inapplicable to the facts of the present case. In the instant case, of course, the Utility

did request an inflation allowance, and its request for such an allowance was supported by competent, substantial evidence in the record uncontradicted by the Commission in the proceeding before it. See, generally, Ex. J-4 and S-4, Supplementary Schedule 1; Ex. J/S-7, pp. 8-14; T:224-225, 228-234, 247, 269-271, 289; the Utility's Answer Brief filed with the First District, at pp. 4-20.

IV.

JUDICIAL NOTICE OF THE EFFECTS OF INFLATION IS APPROPRIATE TO CORROBORATE RECORD EVIDENCE.

In the proceeding below, the Commission chose to ignore both the uncontested evidence in the record concerning the Utility's need for an inflation allowance, and generally known and accepted information concerning the effects of inflation. The Commission's failure to recognize the impact of inflation on the Utility's operations constitutes reversible error.

Although the Commission asserts that the First District erred in its decision below because "[t]he effect of inflation on a utility is not a matter which may be judicially noticed," citing Section 90.202, Florida Statutes [Commission's Brief, p. 15], this Court's opinion in Bould v. Touchette, 349 So.2d 1181 (Fla. 1977), suggests otherwise. In Bould, which involved wrongful death and survivorship actions, this Court stated that it could "consider, as a matter of common knowledge, inflationary tendencies and steady increase in prices." Id. at 1185. Such consideration by a court is clearly within the principles codified by Sections 90.202(11) and (12), Florida Statutes, cited by the Commission [Commission's Brief, p. 15].

In fact, this Court approvingly quoted, in its Bould opinion [id., at pp. 1185-1186], the Second District Court of Appeal's opinion in Seaboard Coast Line R.R. Co. v. Garrison, 336 So.2d 423 (Fla. 2d DCA 1976), a wrongful death action from which the following quotation is taken:

> Appellant, relying primarily on Johnson v. Penrod Drilling Co., 5th Cir. 1975, 510 F.2d 234 (a case brought under the Jones Act), says that such testimony as to future rates of inflation is too speculative and should not be permitted.
>
> Neither party has cited us to a Florida case on point, and our own research has not disclosed any. However, while novel to Florida, this question has been frequently decided elsewhere, and numerous recent cases both permit and prohibit such testimony. See Annot., 12 A.L.R.2d 611, [Section] 15. We think that to require the finder of fact to ignore evidence of reasonably predictable inflationary trends is inconsistent with the realities of present day economics. We align ourselves with the courts that permit such testimony. [Garrison, supra, at p. 424; emphasis added; footnotes omitted.]

The Second District reasoned as follows:

> First, even in the absence of any evidence whatsoever on this matter, we think it likely that juries will consider the impact of future inflation. Inflation has become a fact of life within the experience of everyone. It has continued to a greater or lesser extent throughout most of our lifetimes. Most people have found it necessary to reckon with this in their own financial planning for the future. Certainly juries, which are drawn from citizens from every walk of life, are aware of the effects of inflation. Quite likely they will be prone to consider it in their attempts to fully compensate a plaintiff. On this premise, we think it proper that their judgments be aided by such competent expert testimony as may be relevant to this issue.
>
> Second, the mere fact that the future rate of inflation is uncertain is not a sufficient ground to prohibit the jury from considering expert testimony as to inflationary trends. Juries are constantly called upon to evaluate the effect of future or hypothetical events. As the court stated in United States v. English, 9th Cir. 1975, 521 F.2d 63:

> "While predicting future inflationary trends, or extrapolating from present ones, may be speculative, so are most predictions courts make about future incomes, expenses (as, for example, in the case of the wrongful death of an infant). Since it is still more probable that there will in the future be changes in the purchasing power of the dollar, it is better to try as best we can to predict them rather than to ignore them altogether." [Garrison, supra, at pp. 424-425; footnotes omitted.]

Despite the Commission's opposition, judicial notice of the prevailing inflation rate and extrapolation therefrom for the future are not a novel concept. The Second District Court of Appeal recognized this principle in footnote 3 to its opinion in Garrison, supra:

> The problem is not new. In 1921 the Supreme Court of Vermont in Halloran v. New England Telephone & Telegraph Co., 1921, 95 Vt. 273, 115 A. 143, said:
>
> > "So it is that, at least so far as those elements of damages properly classed as pecuniary losses--like loss of time, loss of earning power, expenses and the like--are concerned, it is proper for the jury to take into consideration the fact, known to everybody, that the purchasing power of money is at present seriously impaired. And it is so held by the courts." [Garrison, supra, at pp. 424-425.]

See also, State of Missouri ex rel. Southwestern Bell Telephone Co. v. Public Service Commission of Missouri, 262 U.S. 276, 43 S.Ct. 544, 67 L.Ed. 981 (1923) [judicial notice taken of increase in price levels; forecast of future increases upheld]; Los Angeles Gas & Electric Corp. v. Railroad Com'n, 289 U.S. 287, 53 S.Ct. 637, 77 L.Ed. 1180 (1933) [downward trend in prices noticed; forecast approved].

In the present case, the Commission chose not only to ignore the uncontradicted evidence in the record concerning the appropriateness of the

requested inflation factor, but also to "blindly ignore projected inflation factors and allow 'zero' for attrition simply because it [was] dissatisfied with the figures proposed by Utilities." Jacksonville Suburban, supra, at p. 372. In its decision below, the First District merely added corroborative reasoning to the evidence presented by the Utility, when the court made references to the well-known effects of inflation.

There can be no serious doubt that the Commission, as the fact-finder below, had both the ability and the regulatory duty to take notice of the impact of inflation on the Utility as supporting the need for the allowance requested by the Utility and substantiated by the uncontradicted evidence in the proceeding below. The Commission not only failed to do so, but rejected the uncontradicted evidence introduced by the Utility. The First District correctly reversed the pertinent portion of Commission Order No. 9533 and remanded it "for determination of an appropriate attrition allowance for the period in question and the taking of such additional testimony as is required for that determination." Jacksonville Suburban, supra, at p. 373.

V.

THE REQUESTED ALLOWANCE COMPLIES WITH GENTEL'S "SEPARATE ALLOWANCE" REQUIREMENT.

The Commission also has concluded, erroneously, that the Utility's requested allowance is not computed as a single adjustment. While it is true that the allowance was computed by analyzing and adjusting each item of expense to determine whether it would be appropriate to apply the 7% inflation factor, the allowance itself was shown as a single item within the operation and maintenance expenses of the Utility set forth on each proposed operating

statement (see, e.g., page 2 of Schedules 5, 6, 7 and 8 attached to the Utility's Proposed Findings [R:494 et seq.]; infra, pp. A-1 through A-4).

The Commission contends that the Utility has failed to meet the requirement enunciated in Citizens of Florida v. Hawkins (Gentel), supra, that only a "separate attrition allowance" be granted [Commission's Brief, pp. 20-21]. Because the Gentel case speaks only to the traditional form of an attrition allowance, Gentel is not entirely applicable to the present case.

Moreover, Gentel was concerned primarily with whether the granting of a "hidden" attrition allowance in the form of a year-end rate base was contrary to the essential requirements of law. The adjective "separate" in the Gentel opinion refers to this Court's holding that the Commission is required to calculate and display an attrition allowance in an open and straightforward manner. Therefore, Gentel cannot reasonably be read to mandate use of the traditional attrition allowance, despite the Commission's suggestion to the contrary.

In this case, the various separate adjustments made to operation and maintenance expenses actually were isolated and identified as a "separate" allowance, as required by the opinion of this Court in Gentel, rather than using the less accurate blanket adjustment apparently favored by the Commission. See, e.g., Ex. J-4 and S-4, Supplementary Schedule 1; infra, pp. A-1 through A-4. The Commission even disallowed the requested adjustments as "separate" amounts (one for each of the four water and sewer operations) [Order No. 9533, at Pages Forty, Forty-Three, Fifty-Two, Fifty-Four; infra, pp. A-5 through A-8.]

VI.

THE UTILITY'S CHOICE OF INFLATION FACTOR IS SUPPORTED BY THE EVIDENCE IN THE RECORD.

The attrition allowance requested by the Utility is supported by competent and substantial evidence in the record. As the Commission itself has acknowledged, "the quantification of future attrition can be nothing more than informed judgement [sic] on the part of the person attempting to predict this occurrence." Re General Telephone Co. of Florida, supra, at p. 372. In the present case, rather than undertaking an extensive and costly study to measure more precisely the past impact of inflation on its operations, the Utility made a conservative and informed proposal to the Commission as to the future impact of inflation. The uncontradicted competent and substantial evidence introduced by the Utility was sufficient to enable the Commission to make an "informed judgment" relating to such an allowance. No evidence was introduced below that the allowance requested by the Utility was excessive. In fact, it has turned out to be a great deal more conservative than the inflation rate actually experienced in the national economy, as the First District observed in footnote 1 to its opinion below.[2]

Significantly, the Commission has recognized that the allowance requested by the Utility consists of two components, known changes and certain other expenses adjusted by the 7% inflation factor:

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[2]"The U.S. Department of Labor reported that the overall 1979 inflation rate, for example, was 13.3%, and that for 1980 was 12.4%. Wall St. J., Jan. 28, 1980, at p. 3, col. 1 & 2; Jan. 26, 1981, at p. 3, col. 1. Both commissions and courts can take judicial notice of the existence of inflation and its effect on a utility company. Missouri ex rel. Missouri Water Co. v. Public Serv. Commission, 308 S.W. 704, 719 (Mo. 1957); Hancock Rural Tel. Corp. v. Public Serv. Commission, 201 N.E.2d 573, 581 (Ind. App. 1964)." [440 So.2d at 372.]

> Mr. Guastella testified that the approach taken by the companies in this case was to compensate for attrition through separate adjustments to each individual operation and maintenance expense account. . . . Where increases after the test year were known, the adjustment was made on the basis of the known change. [T-240]. Otherwise, Mr. Mullen adjusted the expense by an inflation factor of seven percent. [T-239-240]. [Commission's Brief, pp. 18-19.]

The Commission argues, however, that the entire allowance should be disallowed because the 7% inflation factor used by the Utility was "arbitrarily chosen," and that "[t]he Utilities' judgment or opinion standing alone is not competent and substantial evidence." [Commission's Brief, p. 19]. On the contrary, considerable competent and substantial evidence was introduced by the Utility's expert witnesses to support the 7% figure used. Mr. Guastella, the Utility's expert witness who testified concerning the inflation allowance, carefully analyzed the 7% adjustment and concluded that, in his expert opinion, the Utility's adjustment included "reasonable allowances to offset the impact of inflation between the historical test year and the year the rates are expected to be in effect." Ex. J/S-7, p. 12. No contradictory evidence was introduced or identified by the Commission or by Public Counsel.

In any event, it is patently absurd to maintain that the Utility's conservative 7% inflation factor was any more "arbitrarily chosen" than is the 0% inflation factor apparently favored by the Commission in this proceeding. It is clear that the 0% factor cannot be proper. The Commission itself, for example, adopted the figure of 8.99% as an inflation adjustment, known as the "GNP Implicit Price Deflator," pursuant to the inflation indexing procedure mandated in Section 367.081(4)(a), Florida Statutes (1980 Supp.). See, In re:

1981 Price Indexing for Water and Sewer Companies, Docket No. 800777-WS, Order No. 9918 (Mar. 31, 1981) [attached as part of the Appendix, infra, at pp. A-11 and A-12]. The conservative 7% factor used by the Utility, therefore, not only finds substantial, competent evidentiary support in the record, but it also is significantly lower than the 8.99% inflation adjustment for the year 1980 adopted by the Commission and the 12.4-13.3% rate of inflation actually experienced during 1979 and 1980, including the first year during which the new rates were to be in effect. This information was within the knowledge of the Commission at the time that it entered its final order in this proceeding.

In its brief, the Commission admits that "[e]vidence was presented [by the Utility] on the existence of inflation and on a reasonable inflation factor." Commission's Brief, at p. 14. The Commission further states:

> To establish the likelihood of future attrition and therefore, the need for an allowance, the Utilities' [sic] should have presented evidence on how past inflation had affected their ability to earn their authorized rate of return and that further inflation could be expected to affect their ability to earn. [Idem.]

The Utility did just that [Ex. J/S-7, pp. 15-16, infra, at pp. A-9 and A-10; T:244, 253]. The Commission chose, however, to ignore the uncontradicted evidence in the record.

VII.

UPON THE EVIDENTIARY SHOWING BY THE UTILITY, THE BURDEN OF PROOF "SHIFTED" TO THE COMMISSION.

In its opinion below, the First District correctly found as follows:

> Utilities met their burden of proving the necessity for an inflation-attrition allowance by establishing (1) the existence of inflation, a fact which is not contradicted, and (2) a reasonable inflation factor of seven

> percent. At that point, the burden was on the Commission to provide an appropriate figure for the inflation factor. This burden was not met by the Commission. Absent evidence supporting a total denial of the allowance, we find that the Commission's rejection of the testimony of Utilities' experts, based primarily on the methodology used, was an abuse of discretion. [Jacksonville Suburban, at pp. 372-373; footnote omitted.]

The Commission argues, however, that the foregoing quotation "shows a misapprehension of the Commission's function in the case and the law with respect to the burden of proof." Commission's Brief, p. 13. Contrary to the Commission's argument, the First District's reference to "the burden . . . on the Commission" [idem.] is a logical consequence of the fact-finding process, and correctly states the law.

The Commission's characterization of its role in the proceedings below as that of a mere "fact-finder" [Commission's Brief, pp. 13-14] ignores the very real adversarial posture adopted by the Commission Staff in this and other proceedings, in which the Staff introduces evidence, presents proposed findings of fact, and examines and cross-examines witnesses. When the realities of the ratemaking process are recognized, the Commission is seen to take an active role in the evidentiary portion of the proceedings.

A general treatise on Florida law expresses the concept of the so-called "shifting" of the burden of proof in this manner:

> Strictly speaking, the burden of proof does not shift during the course of the trial. It remains with the party on whom it is cast by law. Nevertheless, the phrase "burden of proof" is sometimes used in a secondary sense to designate the obligation resting on a party to meet with evidence a prima facie case presented against him. . . . [M]odern authorities use the term "burden of producing evidence" or "burden of going forward with the evidence" to express this concept; and when used in this sense, the burden may shift several times in one case. [23 Fla.Jur.2d "Evidence and Witnesses" Section 64, p. 90; footnotes omitted.]

See, for example, this Court's opinion in Thomas Jefferson, Inc. v. Motel Employees Union, etc., 84 So.2d 583 (Fla. 1956).

It is in this sense of the term that the First District was correct in declaring that "the burden was on the Commission to provide an appropriate figure for the inflation factor." Jacksonville Suburban, supra, at p. 372. This the Commission did not do, since the record evidence concerning the proper amount of the inflation-attrition allowance presented by the Utility was uncontradicted before the Commission, and, in fact, it remains uncontradicted to this day.

It is obvious that the Commission failed to rebut the Utility's evidence concerning the proper amount of the inflation factor because the Commission chose instead to rely on the confusion surrounding the misuse of the "attrition allowance" nomenclature that has persisted throughout these proceedings. However, in replacing the Utility's 7% factor with a 0% factor of its own, the Commission has itself committed a basic error like that identified by this Court in General Development Utilities, Inc. v. Hawkins, 357 So.2d 408 (Fla. 1978):

> The Commission selected a ratio which nowhere appears in the record, apparently fabricating one for the company based on information it has compiled for water companies generally. The arbitrary selection of this ratio as a "fact" comes from outside the record of the proceeding and plainly violates the notions of agency due process which are embodied in the administrative procedure act. See Section 120.59(2), Florida Statutes (1975), which directs that findings of fact shall be explained by reference to "facts of record"; Section 120.57(1)(b)7, which states that findings of fact "shall be based exclusively on the evidence of record and on matters officially recognized"; and Section 120.61, which contemplates notice of matters to be officially recognized and the opportunity to contest them. [Id., at 409; footnotes omitted.]

In the proceedings before it below, the Commission neither provided nor identified any basis, factual or otherwise, upon which its 0% inflation factor could have been determined. Selection of that factor by the Commission was arbitrary and capricious, and therefore contrary to the essential requirements of law.

VIII.

THE COMMISSION ERRED IN DENYING THE REQUESTED ALLOWANCE.

In the case below, without properly considering the uncontradicted evidence in the record, the Commission denied the requested attrition allowance. The Commission's denial was based on its apparent[3] conclusion that (i) the Utility failed to present competent substantial evidence to support the award of an attrition allowance because no traditional attrition study was undertaken and (ii) the Utility should have utilized "a single adjustment instead of the many adjustments proposed by Jax and Southern Utilities." Order No. 9533, at Page Twenty [R:840]. Further, the Commission determined that in calculating the attrition allowance the Utility "used arbitrary judgment to estimate future costs." Id., at Page Twenty-One.

The uncontradicted evidence in the record, however, clearly supports the granting of the Utility's requested attrition allowance. The granting or denial of the allowance should be based upon the need of the Utility to offset

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[3]The Utility uses the term "apparent" because the Commission failed to state below the specific findings of fact or rationale upon which its rejection of the attrition allowance was founded. See, Section 120.59(2), Fla. Stat. (1979); McDonald v. Department of Banking and Finance, 346 So.2d 569 (Fla. 1st DCA 1977); Wong v. Career Serv. Com'n, 371 So.2d 530, 531 (Fla. 1st DCA 1979).

the erosive effects of inflation, not upon whether the form or methodology employed in computing the Utility's proposed allowance was familiar to the Commission. Public Counsel's witness, Mr. Parcell, admitted that inflation must be considered [T:578], and neither the Commission Staff nor Public Counsel introduced or identified evidence that would establish that the methodology proposed by the Utility was in error or resulted in excessive rates. The Commission's opposition thus was based solely on the fact that the Utility's proposal did not use a method preferred by or familiar to it.

While the Commission's preferred method may also be a satisfactory manner in which to compute an attrition allowance, it cannot be viewed as excluding another method for the computation of an inflation allowance. The Commission has not adopted a formal rule and has no incipient policy concerning the form of such an allowance. The Utility's method of determining an inflation allowance in the present case is not only reasonable, but necessary, in view of the pernicious effect of inflation.

As with the approach adopted by the 1980 Florida Legislature in Chapter 80-99, Laws of Florida, under the Utility's proposed attrition allowance, the future, not the past, impact of inflation has been evaluated, while giving effect to the additional revenues generated by any customer growth. In addition, although both Public Counsel and the Commission Staff cross-examined the Utility's witnesses concerning whether the Utility had experienced attrition or erosion of its earnings during the 1977-1978 test year, no one contended, and no evidence was introduced below which would show, that inflation would not erode the Utility's rate of return during the year in which the new rates were to be placed into effect, if those new rates were based on historical expense levels.

Rather, the Staff argued, and the Commission apparently concluded, that, since the Utility had not produced evidence of the precise impact of inflation in the past, no allowance would be made for the future impact of inflation. Thus, the Commission's inflexible adherence to the traditional methodology of an attrition allowance, when applied to this particular case, is arbitrary and capricious.

The Commission arbitrarily has denied the inflation allowance requested by the Utility without providing a substitute. As a result, the Commission has exposed the Utility to the impact of inflation. The effect of the Commission's denial below is to jeopardize the Utility's ability to earn a fair rate of return and, ultimately, its ability to provide satisfactory service to its customers.

CONCLUSION

The Utility presented competent, substantial evidence supporting the granting of an "attrition (inflation) allowance," and this allowance was denied by the Commission. In its denial, the Commission failed to comply with the essential requirements of law, in that it ignored competent, substantial evidence provided by the Utility, and it made a basic finding of fact not grounded on any evidence in the record indicating that the Utility's requested inflation factor or "attrition allowance" was improper. For this reason, to the extent that it denied the requested allowance, Order No. 9533 should be held insufficient, and the First District's decision below with respect thereto should be affirmed. See, Blocker's Transfer & Storage Company v. Yarborough, 277 So.2d 9 (Fla. 1973):

> . . . where an essential finding is based solely on unreliable evidence or no evidence at all, the order should be held insufficient. [Id., at p. 12; citation omitted.]

Based on the competent, substantial evidence in the record and the authorities cited above, this Court should affirm the First District's decision to remand Order No. 9533 to the Commission with directions to determine the proper amount of an increase in the Utility's operation and maintenance expenses by adding to them the inflation-attrition allowance requested by the Utility.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a true and correct copy of the foregoing has been furnished, by U.S. Mail, to each of the following parties of record, this 24th day of August, 1984:

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