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IN THE SUPREME COURT OF FLORIDA

CITIZENS OF THE STATE OF FLORIDA,

Appellants,

v.

FLORIDA PUBLIC SERVICE COMMISSION,

Appellee.

CASE NO. **75,029**

On Appeal From the Florida Public Service Commission

INITIAL BRIEF OF THE CITIZENS
On Behalf of the Citizens of the State of Florida

Jack Shreve
Public Counsel

Office of Public Counsel
c/o The Florida Legislature
111 West Madison Street
Room **812**
Tallahassee, FL 32399-1400

(904) 488-9330

Attorney for the Citizens
of the State of Florida

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INTRODUCTION

This is an appeal from order no. 22060 of the Florida Public Service Commission relating to the rates charged by United Telephone Company of Florida. Part of order no. 22060 is a notice of proposed agency action; part is final agency action. This appeals the portion of order no. 22060 designated final agency action by the Florida Public Service Commission.

The Public Counsel is charged by section 350.0611, Fla. Stat. (1987) to provide legal representation for the people of the state in proceedings before the Florida Public Service Commission. Jurisdiction is conferred upon this Court by Article V, Section 3(b)(2), Florida Constitution, and sections 350.128(1) and 364.381, Fla. Stat. (1987). Pursuant to Florida Rule of Appellate Procedure 9.220, this brief is accompanied by an appendix which includes a copy of the order to be reviewed. References to the appendix are denoted as (A).

STATEMENT OF THE CASE AND FACTS

On June 22, 1982 the Florida Public Service Commission ("Commission" or "PSC") adopted rule 25-14.003 (A 1) (the "tax rule") to deal with changes in corporate income tax rates. In a full rate case, the Commission sets a utility's rates to allow the company to recover a return on its investment and all of its operating expenses, including taxes. The taxes recovered through customers' rates in a full rate case include the utility's federal corporate income tax expense. The Commission's tax rule takes a change in corporate income tax rates into account after a rate case.

The tax rule defines the term "tax savings" as the difference between a utility's tax expense under old income tax rates and new income tax rates. When the utility's income tax rate decreases, under the rule the utility is liable to refund all or part of the tax savings to its customers if its earnings reach a certain level. Likewise, when the income tax rate increases, the rule allows the utility to collect the increased expense from its customers if its earnings reach a particular level.

This case deals with the situation where income tax expense decreased after the utility's rate case. The Tax Reform Act of 1986 decreased the corporate income tax rate from 46% to 34% effective July 1, 1986. The last rate case of United Telephone

Company of Florida ("United") was conducted in 1982. Under the tax rule, the utility must make a refund of all or part of its tax savings if, at the end of the year, the company earns a rate of return which is at or above the midpoint of its authorized range,. The rule defines the term "midpoint" as the midpoint of the range of return approved by the Commission in the company's last rate case.

The rule says nothing about offsetting required tax savings refunds with other actions by the utility. It says:

> "(2) Tax Savings Refunds . . .
>
> (a) When, during the reporting period described in paragraph (5)(a) below, a utility is earning a rate of return which is at or above the midpoint of its authorized range computed without consideration of a tax rate reduction, the utility shall refund all associated revenues as described in paragraph (5)(c) . . .
>
> (5) Procedures . . .
>
> (c) . . . each utility shall file a petition containing a calculation of and the method for refunding or collecting any tax savings or deficiency for the tax year of the report. The Commission will review the petition and either approve it, approve it with modifications, or deny it; an opportunity for a hearing on the Commission's decision will then be provided, if requested. Thereafter, the utility shall either make the refund to or collect the deficiency from its existing customers in accordance with paragraphs (e) and (f) of this subsection . .
>
> (e) The utility may make any refund or collection either as a lump sum payment or

> billing or in monthly installments not to exceed twelve (12) months. Such refunds or collections shall be made to or from current customers of the utility at the time that such refunds or collections are to be effected. In either event, the utility shall refund or collect the amount with interest accruing on any outstanding balance from the date of overcollection or underpayment. Interest shall be set by the Commission" (A **2-3).**

In addition to the tax rule, a number of Commission orders affect this case. On January 2, **1987** the Commission issued order no. **17053** (A 4) noticing a proposed agency action reducing access charges. In re: Intrastate Telephone Access Charses for Toll Use of Local Exchanse Services, 87 F.P.S.C. **1:79 (1987).** "Access charges" are those charges a local exchange company such as United charges long distance companies to complete the long distance company's calls. The proposed agency action order directed each local exchange company in Florida to reduce its access charges. The order stated:

> "While the revenue effects of reducing access charges are of great concern to us, we do not intend at this time to make specific decisions regarding the recovery of any lost access revenues. We believe that, in addition to local rates, each LEC has various additional sources of revenues available to it which may be used to partially or totally offset any lost access charge revenues. As only one example, we note that the Tax Reform Act of **1986** will result in a tax expense savings for each LEC. This savings may offset the access revenue reduction and, if the tax savings is sufficient, a LEC could reduce its access

charges as we have directed herein and still suffer no net revenue loss.

We reiterate that we are expressly declining to make any provision in this order for any generic mechanisms to offset any access revenue losses. We believe that the affected LECs will be better served if we determine on a case-by-case basis whether any offsetting revenue sources are needed for each specific LEC, and if so, the appropriate means of securing those additional revenues."
Id. at 81 (emphasis added).

Six telephone companies other than United accepted the Commission's proposed agency action order. The Commission's consummating order no. 17173 issued February 9, 1987 (A 10) confirmed the rate reductions for those six telephone companies. United Telephone Company of Florida filed a protest of the proposed agency action and requested a hearing.

But without any hearings, the Commission issued a final agency action order on April 20, 1987, resolving the protest made by United Telephone Company. In re: Intrastate Telephone Access Charges for Toll use of Local Exchange Services, et. al., 87 F.P.S.C. 4:240 (1987) (A 12). The order states that on March 19, 1987, the Commission's staff filed a recommendation that United be ordered to eliminate its estimated 1987 tax savings of $7,150,000 by reducing its access charges effective May 1, 1987, producing an estimated revenue reduction of

$6,700,000 for 1987. It also recommended increasing United's depreciation expense by $568,000 during 1987 to reduce United's revenue requirement by an additional $450,000. United responded to the staff's proposal on March 27, 1987, agreeing to accept the proposed action as a reasonable means of resolving some of the dockets involving United.

The order went on to say that "we will order the disposition of $7,150,000 associated with United's tax expense reduction for 1987. This will be in lieu of the application of Commission Rule 25-14.003" Id. at 241 (emphasis added). Similarly, the order stated that the access charge reduction and depreciation expense increases disposed of United's 1987 savings and tax expense. Id. at 242.

A different order deals with United's 1988 and 1989 tax savings. Commission order no. 19726 issued July 26, 1988 is a notice of proposed agency action authorizing a new rate of return on equity for United during 1988 and 1989. In re: Petition by United Telephone Company of Florida for Approval of a Return on Equity to be Used in 1988 for Purposes of Rule 25-14.003, F.A.C., et. al., 88 F.P.S.C. 7:284 (1988) (A 15). This order states the following:

> "For the two year period 1988-1989, we will authorize an **ROE** (return on equity) for United of 13.5% as a midpoint with a range of 12.5% as a minimum and 14.5% as a maximum. This **ROE** shall be used for all purposes, which shall include, but not be limited to, the following: ... (3) Rule 25-14.003 regarding income tax expense." Id. at 285 (emphasis added).

No party protested this proposed agency action, thereby allowing it to become final agency action.

This order, like the tax rule itself, said nothing about applying access charge rate reductions to offset the refund mechanism contained in the tax rule. Under the tax rule, rate increases or decreases simply affect a company's earnings. Only an earnings test is used to determine a company's liability for a tax savings refund to its customers.

In the first part of 1989 United reported earning a return on equity of 14.28% for calendar year 1988. Though section (5)(c) of the tax rule requires utilities to file a report accompanied by a petition containing a calculation of and method for refunding any tax savings for the year of the report, United submitted none. This led the Public Counsel to file a "Petition to Compel Compliance with Commission Rule 25-14.003 by United Telephone Company of Florida" on April 10, 1989 (A 18). The petition stated that the Commission's rule requires a refund of tax savings either as a lump sum payment or in monthly installments to the extent a

company earns in excess of its midpoint. It argued that since (1) commission order no. 19726 set a midpoint of a 13.5% return on equity applicable to Rule 25-14.003 during 1988, and (2) United earned in excess of that midpoint, it followed that United should refund its tax savings to the extent it earned in excess of a 13.5% return on equity.

United filed its answer on May 2, 1989 (A 21). In its answer United stated that the 1988 effect of its access charge rate reduction made in 1987 reduced its revenues by an amount just greater than its tax savings during 1988 and that it should therefore not be required to refund any of its tax savings to its customers -- even if it did earn in excess of its midpoint return on equity during 1988.

The Commission issued order no. 22060 on October 16, 1989 (A 32), disposing of the Public Counsel's petition. The Commission decided, as final agency action, that United's access charge reduction implemented in 1987 should offset the company's liability for a tax savings refund under its tax rule during 1988. Without citing any provision of its rule, the Commission stated that "the first step in applying the tax rule is to determine the amount of the company's tax savings and then to determine if any of that amount has been disposed of through Commission action" (A 32, 33).

The Public Counsel filed a Notice of Administrative Appeal of this decision on November 15, 1989.

SUMMARY OF THE ARGUMENT

The Commission violated the unambiguous language of its tax rule and its order no. **19726** when it refused to order a tax savings refund to United's customers for **1988.** The rule clearly requires a refund of tax savings if a utility earns above its midpoint return on equity. Order no. **19726** set United's midpoint return on equity at 13.5% during **1988** for the explicit purpose of applying the tax rule. Yet when United reported earnings in excess of this amount during **1988,** the Commission, contrary to its rule, offset the amount of tax savings refund due United's customers by the **1988** effect of a rate reduction to long distance companies United made in **1987.**

The Commission applies its tax rule inconsistently. It offsets the tax savings refunds due customers under its rule by the amount of rate reductions given to long distance companies, but at the same time it ignores customer rate increases levied by utilities.

THE COMMISSION VIOLATED ITS OWN RULE BY REDUCING THE AMOUNT OF TAX SAVINGS DUE UNITED'S CUSTOMERS BY A RATE REDUCTION TO LONG DISTANCE COMPANIES

Generally, an agency's application of its own rules is entitled to great deference. Woodley V. Department of Health and Rehabilitative Services, 505 So.2d 676, 678 (Fla. 1st DCA 1987) (citing Franklin Ambulance Services v. Department of Health and Rehabilitative Services, 450 So.2d 580 (Fla. 1st DCA 1984). "But judicial deference to agency interpretation is not absolute. When the agency's construction clearly contradicts the unambiguous language of the rule, the construction is clearly erroneous and cannot stand." Id. (citing Kearse v. Department of Health and Rehabilitative Services, 474 So.2d 819 (Fla. 1st DCA 1985).

The Commission's tax rule applies to utilities when corporate income tax rates have either risen (resulting in a "tax deficiency") or dropped (resulting in a "tax savings"). In either instance, the utility's midpoint rate of return is the touchstone for determining the extent of the utility's tax deficiency or savings. The tax savings or deficiency is compared against the company's earned return on equity. The rule does not direct the agency to subtract any amount from the tax savings calculation before proceeding to a comparison of the tax savings amount with the utility's earned return on equity and authorized midpoint

return on equity. Order cf. No. 22060 supra at 271 (A 33)("the first step in applying the Tax Rule is to determine the amount of a company's tax savings and then to determine if anv of that amount has been disposed of throuuh Commission action." Id. (emphasis added)). The Commission's order adding this unwritten subtraction step to the procedures is at best an attempt to explicate nonrule policy, and at worst a clearly erroneous interpretation of the plain language adopted through rulemaking. Under either guise, the agency's erroneous action cannot stand.

After comparing the utility's earned return on equity to its authorized midpoint return on equity, the next step is the refund or collection of all or part of the tax savings or tax deficiency amount. When a utility earns below the midpoint of its authorized rate of return, "the utility shall collect all associated revenues." Rule 25-14.003(2)(a), F.A.C. (A 1,2). When the utility earns above its midpoint rate of return, it "shall refund all associated revenues." Id. at 24-14.003(3) (emphasis added). The rule clearly states that a utility "shall refund" the excess tax savings. The use of "shall" makes the refund mandatory. Florida Tallow Corp. v. Bryan, 237 So.2d 308 (Fla. 4th DCA 1970). The rule is plainly worded. It does not state that a utility may make other adjustments in lieu of a refund, nor does it state that the Commission may authorize alternative actions.

Further, the refund procedure outlined by the tax savings rule requires the utility to refund the tax savings either as a lump sum payment or in monthly installments. Rule **25-14.003 (6)**(e), F.A.C. The refund is payable to "current customers of the utility at the time that such refunds are to be **effected."** Id. Additionally, the refund is based on "existing general residence and business local rate relationships." Id. at **25-14.003 (5)**(f). Clearly, the rule directs a utility to return excess tax savings to its customers, not apply the tax savings to the utility's access charges or depreciation expense, nor make any other alternative adjustment. But see order no. **19726** supra at **284** (authorizing additional depreciation in lieu of a tax savings refund) (A **15**).

Should there be any question about the interpretation of the term **"refund,"** other Commission rules supply further clarification. See rule **25-4.114**, F.A.C. (telephone)(A **38**), rule **25-6.109**, F.A.C. (electric)(A **41**), rule **25-7.091**, F.A.C. (gas)(A **43**), and rule **25-**30.360, F.A.C. (water and sewer)(A **46**). Commission rules contemplate per-customer refund of overearnings in the form of a credit on the individual customer's bill, or a check. Only in the event that there are unclaimed refunds do the rules provide for agency discretion in ordering an alternative "method of disposing of the unclaimed refunds." Rule **25-4.114(8)**, F.A.C. (A **40**). Clearly, the Commission has well-defined policies and procedures for identifying and distributing refunds to utility customers.

Section 4 of the tax rule (A 1,2) requires each utility to furnish a final report every year following a tax rate change. This rule further requires that report to be accompanied by a petition containing a calculation of and method for refunding any tax savings for the year of the report. Id. at section (5)(c) cf. id. at section 3(6)(c). United, however, did not file a tax savings report. United claimed that its access charge reduction implemented May 1, 1987, passed back the full impact of the tax rate change to its ratepayers.

United's claim is at odds with the straight forward language contained in the tax rule (A 1) and order no. 19726 (A 15). United failed to file the mandatory tax savings report, denied the existence of any tax savings, and refused to comply with the mandatory refund provisions of the tax savings rule. Whatever carrier access charge reduction United may have provided long distance companies is immaterial both by the terms of the rule and by application of order no. 19726.

Section 120.68, Florida Statutes, directs the court to remand a case to the Commission if the court finds that the agency's exercise of discretion is "inconsistent with an agency rule." Section 120.68(12)(b) Fla. Stat. (1987). In 1984, the Florida Legislature amended section 120.68(12)(b), Florida Statutes (1983), which had permitted an agency to excuse itself from the operation of its rules as long as the agency justified its departure from the

rule. Best Western Travel Inn v. Department of Transportation, 435 So.2d 321 (Fla. 1st DCA 1983). The Legislature found this unacceptable and, in 1984, deleted the provision allowing an agency to deviate from its rules. Section 120.68(12)(b), Fla. Stat. (1987); cf. section 120.68(12)(b), Fla. Stat. (1983). The reasons given for the change were to end confusion and uncertainty in dealing with government agencies.

> The Legislature had provided an extensive rulemaking process in Chapter 120, Florida Statutes, in order to appraise all citizens of the requirements of rules so that they can act accordingly. The court in its ruling in Best Western, allows an agency to depart from its rulemaking by stating its reasons for the departure, thereby bypassing the statutory rulemaking requirements and leaving the citizens not knowing what rules will be followed or what rules will be waived in special circumstances. This Procedure adds confusion and uncertainty in dealing with agencies of state government which was not intended when the Legislature enacted the 1974 revision.

Staff of Fla. H.R. Comm. on Govtl. Ops., HB 1225 (1984) Staff Analysis 2 (April 18, 1984) (available at Fla. Dept of State, Div. of Archives, ser. 18, carton 1534, Tallahassee, FL) (emphasis added).

Recent case law strictly applies the legislative redrafting of section 120.68(12)(b), Florida Statutes. See Decarion v. Martinez, 537 So.2d 1083 (Fla. 1st DCA 1989) (finding that nothing in the language of the agency's rule indicated that it was "simply

advisory rather than mandatory." Id. at 1004); Woodley v. Department of Health and Rehabilitative Services, 505 So.2d 676 (Fla. 1st DCA 1987) (holding that department's construction of its rule regarding policy exception requests "did not comport with the unambiguous language of the rule." Id. at 678); Boca Raton Artificial Kidney Center Inc. v. Department of Health and Rehabilitative Services, 493 So.2d 1055 (Fla. 1st DCA 1986) (finding that department practice was no excuse to deviate from the plain and ordinary meaning of its rules. Id. at 1057). The First District Court of Appeal stated that if an agency finds its rule "impractical in operation," the proper procedure is to amend its rule through statutory rulemaking procedures. Boca Raton Artificial Kidney Center, Inc., 493 So. 2d at 1057.

RECENT EMERGENCY CHANGES TO THE COMMISSION'S TAX RULE SHOW THAT THE COMMISSION KNOWS HOW TO PROPERLY ACCOUNT FOR TAX SAVINGS WITH A MECHANISM OTHER THAN A REFUND

The Commission and United contend that the tax rule allows utilities to account for tax savings in ways other than a refund, such as with access charge rate reductions to long distance companies. They take this position even though the rule requires a refund. A specific issue in this appeal is whether the Commission erred when it declared by order that "the first step in applying the tax rule is to determine the amount of the company's tax savings and then to determine if any of that amount has been disposed of through Commission action" **(A 33)**.

Since the time Public Counsel filed this appeal, the Commission adopted emergency changes to its tax rule. Florida Administrative Weekly, vol. **15**, no. **52**, December **29**, **1989**, at **6160** **(A 49)**. Throughout this emergency rule the Commission changed the phrase **"tax** savings refund" to "tax savings refund or other adjustments made by the Commission."

For example, section (5)(a) of the rule previously dealt solely with refunds; under the new emergency rule, this section now deals with refunds or "other adjustments approved by the Commission." Id. at **6162**.

This shows the Commission knows how to change its rule to accomplish what it did in this case. But in this case, the Commission allowed United to offset its tax savings refund for **1988** by rate reductions to long distance companies even though the rule required refunds when the company earned in excess of its midpoint rate of return.

Under the new emergency rule, the Commissions's actions would be allowable because the rate reductions to long distance companies would be a "other adjustment approved by the **Commission."** Under the rule existing during **1988** and **1989,** however, refunds had to be made. The Commission violated its existing rule when it excused United from making a tax savings refund for **1988.**

THE COMMISSION IGNORES RATE INCREASES WHEN DETERMINING TAX SAVINGS REFUNDS

The Commission's tax rule does not permit utilities to offset tax savings refunds by rate adjustments elsewhere. Rate increases and rate decreases affect a utility's earnings, but it is the level of earnings that determines whether a utility must make a refund, not whether the utility implemented rate increases or rate decreases.

A recent case resol ing the amount of tax savings refund of GTE Florida, Inc., for **1988** shows that the Commission applies its rule inconsistently. In the GTE Florida case the Public Counsel opposed making any offsets to the calculation of tax savings contained in the Commission's tax rule. However, if the Commission offset the amount of tax savings by the amount of an access charge rate reduction to long distance companies, the Public Counsel advocated taking rate increases into account as well.

The Commission refused to take rate increases into account when determiningtax savings. In re: Investigation into the proper application of Rule 25-14.003, F.A.C., relatina to tax savings refunds for **1988** and **1989** for GTE Florida Incorporated, order no.

22352 issued December 29, 1989, at 29-31 (A 53, 81-83).[1] The Commission stated that other rate increases or decreases would affect the company's earnings under the tax rule. Access charge rate reductions were treated differently, the Commission reasoned, because it found it to be so. The Commission "declared" certain rate reductions to be appropriate offsets to the tax rule, while it did not "declare" others to be appropriate offsets Id. at 31 (A 83). It stated:

> "As mentioned above, order no. 17382 accepted GTEFL's CCL and zone charge reductions in lieu of our applying the tax rule. By not protesting this Proposed Agency Action, OPC must be assumed to have agreed to this action as disposing of 1987 tax savings. Because GTEFL's CCL and zone charge reductions are permanent, we have found above that they are appropriate offsets to the tax rule. In our orders approving revenue increases resulting from new service offerings, we have not declared them to be items compelling consideration under the tax rule. Our goals in reducing GTEFL's CCL and zone charges were to deload the nontraffic sensitive costs and to satisfy the tax rule. In the case of some telephone companies, the CCL reduction disposed of all tax savings, satisfying in whole the tax rule, and we required no additional rate reductions. To require that revenue increases offset these rate reductions would not be appropriate absent a finding that such action would be considered as affecting tax savings.
>
> We reject OPC's position that these revenue increases should be used to offset the CCL and zone charge reductions in determining the disposition of GTEFL's 1988 tax savings. However, these revenue increases from new

[1] There is a pending motion for reconsideration by GTE Florida Incorporated on other matters in the order.

> services do raise the levels of the company's earnings and tax savings. While the access and zone charge reductions will have a negative impact on the company's achieved earnings, the increased revenue from new services will increase its achieved earnings. For these reasons, we will adopt our staff's recommendation that increases or decreases of GTEFL revenues, apart from those designated as disposing of tax savings, not be considered in determining whether the tax rule has been satisfied in 1988 and subsequent years." Id. at 30-31 (A 53, 82-83).

All of GTEFL's rate increases and decreases were permanent, and all affected the utility's earnings, whether or not the Commission "declared" or "designated" specific changes as offsets to the refund required by its tax rule. The Commission could find no better reasoning to support its inconsistent application of its tax rule. It "declared" certain rate reductions to be appropriate offsets to its tax rule, but ignored other rate increases not so "declared."

Even while deviating from the plain language of its tax rule, the Commission applied the rule inconsistently.

CONCLUSION

On July 7, 1988, the Commission set United's midpoint return on equity at 13.5% during 1988 and 1989 for all purposes. See order no. 19726, supra at 285 (A 15, 16). All parties accepted this proposed agency action order by allowing it to become final agency action. The order squarely stated that this return on equity would apply to its tax rule and, like the rule itself, said nothing about offsetting refunds required by the rule by other actions of the utility. Id.

The earnings surveillance report of United for the calendar year 1988 shows an achieved return on equity of 14.28% -- an amount well in excess of the 13.5% return on equity set by order no. 19726. But now that United earned in excess of its midpoint return on equity during 1988, it claims it owes no tax savings refund to its customers. And the Commission refuses to enforce the return on equity set in 1988, even though its 1988 order specifically said that the 13.5% midpoint return on equity would be used with its tax rule ("For the two year period 1988-1989, we will authorize an ROE (return on equity) for United of 13.5% as a midpoint . . . This ROE shall be used for all purposes, which shall include, but not be limited to, . . . Rule 25-14.003 regarding income tax expense." Order no. 19726, supra at 285 (A 16)).

The Commission should have followed its order and rule by ordering United to refund the excess tax savings to its current customers. By operation of section 120.68(12)(b) Florida Statutes, this Court should remand this case to the agency with directions to refund United's tax savings in excess of 13.5% to its customers.

Jack Shreve
Public Counsel
Fla. Bar no. 73622

Charles J. Beck
Assistant Public Counsel
Fla. Bar no. 217281

Office of Public Counsel
c/o The Florida Legislature
111 West Madison Street
Room 812
Tallahassee, FL32399-1400

(904) 488-9330

Attorneys for the Citizens
of the State of Florida

CERTIFICATE OF SERVICE
DOCKET NO. 890486-TL
CASE NO. 75,029

I HEREBY CERTIFY that a copy of the foregoing has been furnished by U.S. Mail or hand-delivery to the following parties this 24th day of January, 1990.

Jerry Johns
United Telephone Company
P.O. Box 5000
Altamonte Springs, FL 32716

Tracy Hatch
Division of Legal Services
Fla. Public Service Commission
101 East Gaines Street
Tallahassee, FL 32301

Susan Clark
General Counsel
Fla. Public Service Commission
101 East Gaines Street
Tallahassee, FL 32301

Charles J. Beck
Assistant Public Counsel