IN THE SUPREME COURT OF FLORIDA

GULF POWER COMPANY, Appellant, vs. FLORIDA PUBLIC SERVICE COMMISSION, Appellee.	)	CASE NO. 77,153

ANSWER BRIEF OF THE FLORIDA PUBLIC SERVICE COMMISSION

SUSAN F. CLARK
General Counsel
Fla. Bar No. 179580

DAVID E. SMITH
Director of Appeals
Fla. Bar No. 309011

FLORIDA PUBLIC SERVICE COMMISSION
101 East Gaines Street
Tallahassee, Florida 32399-0862
(904) 488-7464

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SYMBOLS AND DESIGNATIONS OF THE PARTIES

Appellee, The Public Service Commission, is referred to in this brief as the "Commission." Appellant, Gulf Power Company, is referred to as "Gulf," or "Appellant."

References to the record on appeal are designated (R). References to the transcripts of the hearing and service hearings in Panama City and Pensacola which are respectively designated (TR), (Panama City Serv. TR), and (Pensacola Serv. TR). References to exhibits introduced into evidence at hearing are designated (Ex.).

STATEMENT OF THE CASE AND FACTS

The Commission generally accepts all statements of the facts in the case. However, the Commission believes that the Court's understanding of the issue involved in this case would be aided by certain additional facts relating to the issue of mismanagement which is the subject of this appeal.

Serious allegations of improprieties at Gulf surfaced in December 1983. (TR 30). At that time, Gulf president, Doug McCrary, received anonymous letters which accused Gulf employee, Kyle Croft, manager of general services operations, in the theft of Gulf property from its warehouse and the misuse of Gulf employees. (TR 84; 192; 2982). In response to these allegations, President McCrary ordered an investigation by security personnel from Gulf's sister company, Mississippi Power Company. (Ex. 391). The investigation was completed and a report known as the Baker-Childers Report was presented to President McCrary in January of 1984. (TR 165; Ex. 391). The report contained allegations that Gulf employees had performed unauthorized personal services for Vice President Jacob Horton, Ben Kickliter, and Kyle Croft. (TR 167). On the basis of the investigation and an audit and inventory of Gulf warehouses, it appeared that Croft had been misusing company employees and converting company property and supplies for his own use. (TR 2981). President McCrary confronted Croft and asked for his resignation. Croft refused to resign and was subsequently fired by McCrary. Thereafter, Vice President Horton interceded on behalf of Croft and persuaded McCrary to allow Croft to resign, if he admitted to stealing approximately $16,000 in supplies, equipment, and labor from the company. Croft signed a promissory note to Gulf for $15,986.62. In return, Gulf agreed not to subject Croft to criminal action. Croft resigned, and now receives a pension from Gulf. (TR 193-199; 2982).

At the time of the Croft episode, President McCrary questioned Vice President Horton about the allegations of company personnel and material being used for his personal benefit. Mr. Horton denied the allegations, but the incident did raise some suspicions in the President's mind that Mr. Horton might be involved in improper activities. (TR 168-169). No further investigation of Mr. Horton was made at that time. (TR 169).

In June of 1984, another incident of improper conduct surfaced at Gulf. It was discovered that an employee had delivered approximately $10,000 worth of appliances to Mr. Ed Addison, former president of Gulf and current president of the Southern Company. When the President learned of the delivery, he or a subordinate talked to Mr. Addison, and Mr. Addison agreed to pay for the appliances. (TR 186). The employee who intended to give the appliances to Mr. Addison, Mr. Yarborough, was under the corporate group headed by Vice President Horton. (TR 186). President McCrary's suspicion of Mr. Horton was heightened by this incident, but no further investigation was made. (TR 186-187).

Another episode involving Mr. Horton surfaced in 1984 when it was found that he had instructed an employee to solicit a $1,000 political contribution from a local architect with whom Gulf had contractual relationships. (TR 222-223). The President learned of the solicitation a couple of days after it occurred. (TR 223). Horton claimed the incident was basically a misunderstanding, and McCrary accepted that explanation. However, he did emphasize to Horton that the company would not be in the business of pressuring vendors to make political contributions. (TR 224).

More facts concerning the Croft affair came to light in 1986. At that time, Mr. Croft had filed suit against the company and six current and former executives. Croft sought recision of his resignation, cancellation of the $15,986.62 promissory note, and other damages for alleged conspiracy and defamation, liable, and intentional infliction of emotional distress. (TR 2982). It came to light at that time that Vice President Horton had executed a promissory note back to Mr. Croft for the amount Croft had agreed to pay Gulf as a result of his criminal activities. This again raised the President's suspicion of Mr. Horton. (TR 199).

Further details of the Croft episode came to light in 1988 when it was learned that Mr. Horton had also arranged to pay Mr. Croft's attorney's fees and insurance, contrary to the President's orders. (TR 197).

Two significant events occurred in 1988 which revealed the extent of improper activities by Gulf, Vice President Horton, and other employees. First, a Pensacola grand jury indicted employees Croft, Joseph L. Brazwell, Supervisor of Support Services, and Richard Leeper for evading income taxes on money fraudulently obtained from Gulf. Gulf's investigation revealed that Brazwell had been involved in a scheme to defraud Gulf of $42,000 through the submission of false invoices from Gulf vendors. (TR 2983). Croft pleaded guilty to the tax charges and received a four-month sentence and a $10,000 fine. Brazwell likewise pleaded guilty and was sentenced to nine years in prison and a $30,000 fine. Leeper was sentenced to 18 months for lying to the Grand Jury. (TR 2985).

In 1988, the top financial officers of the Southern Company and its subsidiaries, including Gulf, came under investigation by a Federal Grand Jury in Atlanta. The investigation was based on an Internal Revenue Service report that claimed that top financial officers of Southern Company and its subsidiaries had conspired with the Arthur Andersen accounting firm since 1982 to avoid paying tens of millions of dollars in federal income taxes. As a result of the Grand Jury investigation, Gulf agreed, on October 30, 1989, to plead guilty to two counts of making illegal political contributions and obstructing the Internal Revenue Service in its audit functions and collection of income taxes. (TR 2989; Ex. 413). Gulf agreed to pay a $500,000 fine for its illegal activities. (Ex. 413).

The Grand Jury investigation had revealed that Mr. Horton and his subordinates were extensively involved in a scheme to make illegal political contributions and other improper payments through outside vendors. (TR 245-246; 2991; Ex. 413, pp. 13 et seq.). At the hearing on Gulf's proposed rate increase, Mr. McCrary conceded that these illegal activities would likely have consumed a good deal of the Vice President's time. (TR 246). The illegal activities addressed in the plea agreement occurred over the period 1981 to 1988. No specific investigation of Jake Horton was ever undertaken by Gulf. (TR 234). However, an investigation was conducted by the audit committee of Gulf's board of directors which looked into Horton's activities. (TR 234). Mr. Horton was killed on April 10, 1989, in a plane crash before any further action was taken by the company.

The publicity surrounding the various lawsuits and investigations of Gulf employees were brought up by several customers of the utility expressing their opposition to a proposed rate increase. At the Pensacola service hearing, public witness Goudy testified:

> Now with the seeming corruption and kickbacks that are turning up in the newspaper, and with certain tax questions, I suggest that perhaps there were kickbacks in the construction costs as well, and all this leads me to believe that Gulf Power management -- how shall I put it, I guess bluntly, is either incompetent or questionable integrity. I believe this rate increase should be denied until irrefutable of proof of a need is shown.

(Pensacola Serv. TR 20).

Customer witnessses Smith, Taylor, Patten, and Walmer expressed the same kind of concerns. (Pensacola Serv. TR 24; 31-32; 40-41, 44; 65).

At the rate hearing, PSC witness Roberta Bass concluded that Gulf had been ineffective in dealing with its internal problems. She stated:

> Although collusion and management override can circumvent and render ineffective even the strictest internal controls, the criminal

> activity documented as having occurred at Gulf Power extended over a period of approximately eight years. The inability of Gulf management to discover and correct these overt illegal actions leads me to believe that the corporate culture was such that employees believed these types of illegal actions were, at least, condoned by top management.

(TR 2994).

Ms. Bass concluded that the Commission should make the factual finding that Gulf had been grossly mismanaged and that its return on equity should accordingly be adjusted. (TR 2994).

SUMMARY OF THE ARGUMENT

It is universally recognized that a utility is only entitled to the opportunity to earn a reasonable rate of return on its investment. That return is normally established as a percentage range, and may reflect factors other than economic costs. Florida law has specifically recognized that the setting of a rate of return is a matter for which the Commission has special expertise. Adjustments for management efficiency are one of the factors which the Commission may consider in setting a rate of return.

The Commission's temporary reduction in Gulf's return on equity for management inefficiency is consistent with past practices of the Commission and the holdings of this Court. The practice of making such adjustments has likewise been recognized in many other jurisdictions and upheld by reviewing courts. When the Commission makes adjustments to equity to reflect management efficiency, it does so to encourage constructive management policies and discourage those policies that are inimical to the interests of the utility and its ratepayers. There is no requirement that such incentives or disincentives be granted only in light of specific, quantifiable effects on services and facilities.

The Commission's fifty basis points reduction in Gulf's return on equity does not constitute an impermissible administrative penalty under Article I, Section 18 of the Florida Constitution. That section contemplates an agency's exercise of its enforcement power to assure compliance with its statutes, rules, and orders.

The specific statutory authority embodying the Commission's enforcement power over electric utilities is found at section 366.095, Florida Statutes. Under that provision, the Commission can impose monetary penalties which create liens on the personal property of utilities.

The Commission has not attempted to impose any such monetary fine on Gulf in this case. The Commission has simply exercised its recognized ratemaking discretion to adjust Gulf's return on equity as an incentive toward improved management efficiency and avoidance of the problems that have plagued the utility for the last eight years. Gulf should not be heard to complain about the Commission's exercise of discretion against it in this instance, especially when it has enjoyed the benefits of an increased equity return for good management in the past. The Commission must be able to discourage mismangement as well as encourage good management through adjustments to the equity return.

The Commission's adjustment to Gulf's equity return in this case does not violate any ratemaking concepts. Neither the test year concept nor the concept of retroactive ratemaking have any direct application to this case. The incidents of mismanagement which the Commission sought to discourage occurred over a period of eight years and could hardly have been contained in the 1990 projected test year which Gulf sought. The test year is a functional analytical tool which allows a commission to determine the utility's current level of investment and costs. It is not a sacrosanct concept which admits of no practical adjustment. The test year concept has no direct application to measuring the pattern of corporate behavior. The concept of retroactive ratemaking applies to the setting of rates which attempt to recover past losses or refund past overcharges. The concept is not a roadblock to the Commission's ability to analyze past management behavior and correct it by present action.

The Commission had before it abundant evidence of Gulf's mismanagement, both in the conduct of the president, and in the specific unethical and illegal behavior of Vice President Horton and his associates. The Commission correctly recognized that the events of the last several years at Gulf have severely affected its internal operations and its image as a public utility. The Commission correctly found, as the United States Supreme Court has, that such controversy and turmoil in a public utility's affairs must necessarily lead to inefficiency and other effects deleterious to the utility and the public. The Commission was correct in its judgment that it was necessary to "send a message" to Gulf that such inefficiency and mismanagement cannot and will not be tolerated in Florida.

Constitutional protections are not available to remedy a utility's discontent with individual aspects of the ratemaking process. Only when the various adjustments to expenses, rate of return, and rate base have the combined effect of confiscation does the law limit the ratemaking agency's discretion.

Gulf's return on equity was set in a range of 11.75 to 13.5 percent. Gulf has not alleged that this range is confiscatory, nor that the fifty basis points penalty will cause it to earn outside that range. Gulf simply claims that it should be entitled to more and that it is being unfairly penalized by the Commission. The Commission's order cannot be disturbed on this basis.

This Court has recognized that its role is not to second guess the judgment of the Commission where there is no evidence of confiscation. This Court has likewise declined to intervene in the ratemaking process and substitute its judgment for that of the Commission under such circumstances.

ARGUMENT

I.

THE COMMISSION'S FIFTY BASIS POINTS REDUCTION IN GULF'S RETURN ON EQUITY FOR MANAGEMENT INEFFICIENCY WAS A PROPER EXERCISE OF RATEMAKING DISCRETION

In its initial brief, Gulf has painted a picture of a public utility commission that is powerless to deal in a straightforward manner with the inadequacies of a utility's management. Gulf has labelled the Commission's two-year reduction in the utility's return on equity an unconstitutional "penalty." It has attempted to set up road blocks to the Commission's ratemaking authority which would prohibit it from even considering the turbulent recent history of Gulf's management. According to Gulf, the Commission is supposed to be content with a "trust me" from Gulf's management and a promise of restitution, if the Commission or anyone else can come up with exact dollar losses to ratepayers. Gulf's arguments are largely semantic and based on a misconstruction of Florida law.

A. THE COMMISSION HAD THE AUTHORITY TO CONSIDER MANAGEMENT EFFICIENCY IN SETTING GULF'S RETURN ON EQUITY

As this Court and others have said on innumerable occasions, a regulated utility is only entitled to "an opportunity to earn a fair or reasonable rate of return on its invested capital." (Citation omitted). United Telephone Company of Florida v. Mann, 403 So.2d 962, 966 (Fla. 1981). Determining what constitutes a fair and reasonable return for any given utility depends on the unique facts and circumstances attendant to that utility's operations. United Telephone Company v. Mayo, 345 So.2d 648, 654

(Fla. 1977). The determination is ultimately one not "susceptible to ordinary methods of proof," but is "essentially a matter of opinion which necessarily ha[s] to be infused by policy considerations for which the PSC has special responsibility." Utilities Inc. of Florida v. Florida Public Service Commission, 420 So.2d 331, 333 (Fla. 1st DCA 1982).

This Court has recognized the Commission's broad range of discretion in setting a return on equity and has explicitly stated that a return may be adjusted to "account for such things as accretion, attrition, inflation, and management efficiency." (Emphasis supplied). Mann, supra, 403 So.2d 966.

The Court has further specifically upheld the Commission's exercise of its discretion to consider management efficiency in setting a return on equity. In an appeal arising out of Gulf's 1980 rate case, Gulf Power Company v. Cresse, 410 So.2d 492 (Fla. 1982), the Court upheld as within the Commission's ratemaking discretion the granting of a reward to Gulf of ten basis points on its return on equity for its conservation efforts. The Court did not attempt to look behind the Commission's judgment in making that award, as Gulf would have it do in this case. The Court simply noted its agreement with the Commission that it had not "violated the essential requirements of law nor abused its discretion" in making the award. Id. at 494.

In Gulf's 1980 case, the Commission was motivated to recognize the exemplary behavior of Gulf's management in promoting conservation, as in this case it was motivated to provide an incentive to Gulf that the abuses of management not recur. In Order No. 9852, the 1980 Gulf rate case order, the Commission stated:

> With regard to the ten basis points added to the return on equity capital used for ratemaking purposes, we believe that once we have identified an appropriate range for a fair rate of return consistent with the record, we have some discretion in fixing the point within the range to be used to determine revenue requirements. In this instance, we exercised our authority in this regard to reward Gulf's visible efforts in promoting conservation, an objective which we hope that management of all utilities will strive to achieve.

In re: Application of Gulf Power Company for Authority to Increase its Rates and Charges, 81 FPSC 3:25, 27.

In the earlier Gulf case, as in the instant case, the Commission's focus was on the policies and attitudes of management in the operation of the utility. The Commission did not tie its exercise of discretion to some specific dollars and cents effect on "service or facilities" as appellant would have it. While individual imprudent management decisions may result in a utility incurring otherwise unnecessary expenses such as additional fuel costs, and may be corrected by disallowing those expenses, the emphasis is different where there is a pattern of mismanagement and inefficiency over an extended period of time. In the latter instance, the object is to provide clear incentives to avoid such behavior in the future and not to reward behavior which is inherently inimical to the interest of the utility and its ratepayers.

The idea of increasing or decreasing the utility's return on equity based on the performance of management is by no means new to this Commission nor unique to Florida. There are a great number of cases in Florida and other jurisdictions in which this means of addressing management efficiency has been used.[1] See Re Florida Power Corporation, 73 PUR 3d 295 (Fla. P.S.C. 1968) (electric utility was held to a lower rate of return for its inability to achieve a satisfactory decree of efficiency in controlling the level of its rates); In re: Petition of West Florida Natural Gas Company for an Increase in Rates and Charges, 86 FPSC 9:74 (the

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[1]Indeed, leading commentators on public utility regulation have suggested that a rate of return differential would be a desirable technique for recognizing management efficiency or lack thereof. In Principles of Public Utility Rates, 2d ed., 1988, pp. 366-367, authors Bonbright, Danielson, and Kammerschen write:

> While exceptional management is rarely explicitly rewarded, and mediocrity infrequently penalized, it suggests more systematic and deliberate efforts on the part of regulating agencies to distinguish, somewhat as competition is presumed to do, in favor of companies under superior management and against companies with substandard management. The differential might take the form of an explicit and publicly recognized differential in the allowed rate of return. There is ground for the conviction that the opportunity of a well-managed utility to earn a return liberally adequate to attract capital is in the public interest as encouraging rapid technological progress and long-run policies of operation. Objection might be raised to a substandard rate of return on the grounds that it would make bad matters worse, but one might hope that the restriction of a company, by virtue of a return measured, say, by a bare bones estimate of the cost of capital, could become so intolerable to the stockholders that they would enforce a change of management.

Commission reduced return on equity fifty basis points because of management's failure to timely inform the Commission of material changes affecting validity of its rate application); Re General Telephone Company of Florida, 44 PUR 3d 247 (Fla. P.S.C. 1962) (the Commission found utility had demonstrated the ability to operate efficiently and deserved specific recognition through an increase in its return on equity); Re South County Gas Company, 53 PUR 4th 525 (R.I. P.U.C. 1983) (Rhode Island Commission imposed a penalty on an electric utility's allowable rate of return on equity to assure management that the Commission was outraged by the utility's neglect of its public service obligations); Re The Pacific Telephone and Telegraph Company, 16 PUR 4th 384 (Cal. P.U.C. 1976) (California Commission reduced telephone company's assigned rate of return as a result of unreasonable budget management); LaSalle Telephone Company v. Louisiana Public Service Commission, 157 So.2d 455 (La. 1963) (Louisiana Supreme Court upheld Louisiana's Commission reward for good management in increased rate of return); and State ex rel. Utilities Commission v. General Telephone Company of the Southeast, 208 S.E.2d. 681 (N.C. 1974) (North Carolina Commission refused to grant otherwise justifiable increase in return from 6.65 percent to 8.02 percent where indifference of top management and operating personnel had caused chronic deterioration of service.)

B. THE COMMISSION'S REDUCTION TO GULF'S RETURN ON EQUITY IS NOT AN UNAUTHORIZED PENALTY

Although the Commission only used the term one time in its order (R 2407), appellant has labelled the Commission's action a "penalty" and has doggedly repeated its argument that the Commission's action violates the Constitutional prohibition against the imposition of administrative penalties in Article I, Section 18 of the Florida Constitution.

The Commission's reduction to Gulf's equity return is not a penalty in the legal sense of that term as it is used in Article I, Section 18.[2] It is not an extraction of money by the state for the violation of a statute, rule, or order as contemplated by Article I, Section 18. Nor is it a fine under the Commission's own penalty statute for electric utilities, section 366.095, Florida Statutes. That statute provides that the Commission may impose a penalty of up to $5,000 per day per violation of any of its rules, statutes, or orders. The normal procedure for invoking the Commission's power under that statute is the issuance of an order to show cause why a fine should not be imposed for some specific violation. Imposition of the fine creates a lien against the property of the

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[2]The Texas case relied on by Gulf, Public Utility Commission of Texas v. Houston Lighting and Power Company, 715 S.W.2d 98 (Tex. Ct. App. 1987), is inconsistent with ratemaking concepts of the Florida Commission and the other commissions that allow adjustments for management efficiency. On the facts of the case it is not clear why the court chose to label the Texas Commission's adjustment an impermissible penalty while recognizing that management efficiency should be considered and even rewarded where appropriate. The Texas court recognized that its decision was not in line with other jurisdictions and appears to have seized on an arbitrary notion that penalties must be service related to distinguish away other cases. Id. at 103. How such adjustments are essentially different than other adjustments to expenses and rate base for imprudent management decisions is not readily apparent in view of the U.S. Supreme Court's holdings in the line of cases discussed below at pp. 22-24. These cases hold that ratemaking discretion ends and judicial review begins at the point where a utility shows a confiscatory rate has been set, by whatever means.

offending utility which is enforceable in court. Monies collected under this provision are paid into the state treasury.

The Commission has not ordered Gulf to pay any money to the state. The penalty involved is a lost opportunity to earn an extra one-half percent on equity for the next two years. The Commission's withholding of that opportunity derives from its power to regulate electric utilities in the public interest. In section 366.01, Florida Statutes, the Legislature has stated that the regulation of electric utilities is an exercise of the police power and that power specifically carries with it the authority to exercise discretion in determining what measures are necessary to protect the public interest. State v. Atlantic Coast Line R. Co., 47 So. 969 (Fla. 1908).[3]

In this case, the Commission has found that Gulf's management must be provided an incentive to do a better job in keeping its house in order and avoiding the corruption and turmoil that have plagued it in the last several years. If Gulf were to prevail with its argument, the effect would be to limit the Commission's discretion with regard to management efficiency. The Commission

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[3]This Court has recognized the Commission's power to make adjustments to equity returns for management efficiency in the Mann and Cresse cases, supra. Both the power to reward efficiency through an increased equity return, and to discourage it through a decrease, are powers necessary to effectuate the regulatory purposes of the Commission. (See Deltona Corporation v. Florida Public Service Commission, 220 So.2d 905, 907 (Fla. 1969) ("A statutory grant of power or right carries with it by implication everything necessary to carry out the power or right and make it effectual and complete.")

could reward management efficiency, but it would not be able provide disincentives for inefficiency.

C. THE COMMISSION'S REDUCTION OF GULF'S EQUITY RETURN DOES NOT VIOLATE FUNDAMENTAL RATEMAKING PRINCIPLES

Appellant's argument that the Commission violated technical ratemaking concepts is without merit. Gulf is correct that the alleged violations which the Commission found to be mismanagement did not occur in the test year. That is not surprising, given the nature of the irregularities which occurred over eight years, and the fact that the test year was the projected year 1990. (R 2407). Gulf's argument on this point is at best somewhat contrived, since the issue of mismanagement would have been considered in the rate case Gulf filed in 1988, had not the utility withdrawn it in the face of the federal grand jury investigation. (R 1; TR 26-27; Order No. 21459, In re: Investigation of Gulf Power Company, 89 FPSC 6:505.)

The test year is not a sacrosanct concept. It is merely an analytical device that measures a utility's current level of investment and income to determine what revenues will be necessary for a fair rate of return in the future. Citizens of Florida v. Hawkins, 356 So.2d 254, 256 (Fla. 1978); Gulf Power Company v. Bevis, 289 So.2d 401 (Fla. 1974). A test year is not a device that measures a pattern of corporate behavior. Gulf's attempt to apply that concept to the Commission's reduction in Gulf's equity for mismanagement is essentially ridiculous. The test year in Gulf's rate case was the discreet time period the Commission used to determine the cost of debt, preferred stock, market cost of common equity, and other elements in the utility's capital structure. It had nothing to do with establishing or measuring the attitudes, misconduct, and inefficiencies which the Commission addressed in its order.

The concept of retroactive ratemaking likewise has nothing to do with the Commission's action in this case. Retroactive ratemaking occurs "when an additional charge is made for past use of utility service, or the utility is required to refund revenues collected, pursuant to then lawfully established rates, for such past use." 81 FPSC 3:25, 29, citing Utilities Commission v. Edmisten, 232 S.E.2d 184 (N.C. 1977). The Commission has instituted no such additional charge or refund in this case.

The concept of retroactivity does not prevent the Commission from analyzing behavior which it knows has occurred and which it finds must be addressed. The exact temporal locus of Gulf's mismanagement is of little significance to the Commission's decision. The problem it perceives and the need to provide incentives to correct the problem exist here and now. The Commission would indeed be cast in an untenable position if it followed the Appellant's reasoning. The Commission would simply fold its hands and do nothing because it didn't catch the utility "in the act." The law does not require the Commission to be blind to reality; its duty to the utility and its ratepayers do not allow it to be.

The Commission had before it abundant evidence of Gulf's mismanagement. As the Commission explained in great detail in its order, the actions of the President and other senior managers in failing to react quickly and with sterner measures to the theft and corruption within the company constituted mismanagement. The President and his four Vice Presidents functioned as a group in management decisions, and the President had reason to suspect that Vice President Horton was involved in improper activities in 1984, 1986 and 1988. Yet Mr. Horton's conduct during that time was never investigated, nor was he reprimanded when it was clear that he had defied the President's instructions in the Croft affair. Only after the proverbial roof had fallen in with the grand jury investigation, and the extensive involvement of Mr. Horton in illegal political activities and kickbacks became publicly known, was there a move by the audit committee to determine what Mr. Horton had been up to. (Order 22-29; R 2422-2429).

The Commission certainly was justified in finding that the undisputed evidence of Mr. Horton's own unethical and illegal activities, as revealed in the plea agreement, and confirmed by the President's own testimony, constituted mismanagement. Even the President acknowledged that Mr. Horton must have devoted a good deal of his time to his improper activities. (p. 4, <u>supra</u>). Surely, there can be no doubt that his activities detracted from the effective and honest management of the company. What Mr. Horton did in his position of power would constitute mismanagement in any company, much less in a public utility which enjoys a special status imbued with the public trust. It was hardly a matter of the Commission's "intuition," as Appellant argues, (Initial Brief at 29) that the effectiveness of Gulf's management was lessened by the scandals which have plagued it.

Gulf would have this Court believe that the Commission can only deal with mismanagement if the customers are receiving substandard service. Quite apart from any specific injury to service and facilities, however, Gulf's image as a public utility and its internal operations have been severely affected. That is a very significant thing, and one which the Commission must recognize in its role as regulator. The U.S. Supreme Court summed it up excellently in <u>State of Missouri ex rel. Southwestern Bell Telephone Company v. Public Service Commission of Missouri</u>, 67 L.Ed. 981, 994 (1923). Speaking of the problems caused by recurrent rate cases the Court noted:

> Instability is a standing menace of renewed controversy. The direct expense to the utility of maintaining an army of experts and of counsel is appalling. The attention of officials, high and low, is, necessarily, diverted from the constructive tasks of efficient operation and of development. The public relations of the utility to the community are apt to become more and more strained. And a victory for the utility may, in the end, prove more disastrous than defeat would have been. The community defeated, but unconvinced, remembers; and may refuse aid when the company has occasion later to require its consent or co-operation in the conduct and development of its enterprise. Controversy with utilities is obviously injurious also to the public interest. The prime needs of the community are that facilities be ample and that rates be as low and as stable as possible. The community can get cheap service from private companies only through

> cheap capital. It can get efficient service only if managers of the utility are free to devote themselves to problems of operation and of development. It can get ample service through private companies only if investors may be assured of receiving continuously a fair return upon the investment.

As the Supreme Court recognized, controversy and turmoil in public utilities' affairs necessarily must lead to inefficiency and other effects deleterious to the utility and the public. It would be naive for the Commission to assume, as Appellant argues, that the only thing the Commission should be concerned about is potential dollars lost though internal corruption at Gulf. Ultimately, the problems of inefficient management have everything to do with service, whether the effects at any given time are readily quantifiable in terms of the dollars and cents needed to make improvements. See General Telephone Company of the Southeast, supra, 208 S.E. 681, 684-687; 690. The Commission had a responsibility as regulator to, as it said, "send a message" to Gulf that mismanagement and the problems it engenders will not be tolerated in Florida. (Order at 29; R 2429).

D. THE TEMPORARY REDUCTION IN GULF'S RETURN ON EQUITY WILL NOT CAUSE IT TO EARN LESS THAN A FAIR RETURN

The law is clear that a utility is only entitled to the opportunity to earn a fair rate of return. Mann, supra, 403 So.2d 966. The Commission established Gulf's allowable return on equity in a range of 11.75 percent to 13.5 percent with a midpoint of 12.55 percent. The application of the fifty basis points reduction reduced that return on equity to 12.05 percent. Gulf has not, and can not on this appeal, make any claim that the penalty results in confiscatory rates. The utility has not challenged the 11.75 to 13.50 percent range and indeed only time will tell whether the "penalty" imposed by the Commission in fact has any effect on Gulf's earnings. If the utility only earns at 11.75 percent, then it would make no difference that the Commission proposed to reduce its return to 12.05 percent. Gulf's rates were indeed set on the basis of a 12.05 percent return on equity; however, there is no guarantee that other factors affecting its rates, quite apart from anything the Commission has done, may cause Gulf to earn less than 12.05 percent. In any event, the certainty with which Gulf has stated the effect of the reduction is questionable.

Gulf has not even alleged confiscation in this instance, much less established it in its arguments. It simply claims that, in its opinion, its shareholders should be entitled to more. The setting of a fair rate of return, however, necessarily involves a balancing of the interests of the investors and ratepayers. <u>FPC v. Hope Natural Gas Co.</u> 320 U.S. 591, 64 S.Ct. 281, 88 L.Ed. 333, 345 (1944). As the U.S. Supreme Court observed in <u>Permian Basin Area Rate Cases</u>, 390 U.S. 747, 88 S.Ct. 1344, 20 L.Ed.2d 312, 337 (1968) the "investors' interests provide only one of the variables in the constitutional calculus of reasonableness." (Citations omitted). Discontent with one aspect of the complex process of ratemaking does not entitle a utility to constitutional protection where it is not shown that the overall effect of the process is to produce an inadequate return to equity holders. <u>Duquesne Light Company and</u>

Pennsylvania Power Company v. Barash, 488 U.S. 299, 109 S.Ct. 609, 102 L.Ed.2d 646, 660 (1989). Even with the fifty basis points reduction, Gulf's equity return still falls within the range of reasonableness. On that conclusion, judicial inquiry should be at an end. Id. at 659.

The evidence supports the Commission's findings that Gulf has experienced management problems which must be addressed. This Court has said that it will "refuse to meddle with the judgment of the Commission," where it finds no evidence of confiscation in the rate of return set by the Commission. Mayo, supra, 345 So.2d 654. In this case, the Court should decline Gulf's invitation to intervene in the ratemaking process and substitute its judgment for that of the Commission. Citizens of Florida v. Public Service Commission, 435 So.2d 784 (Fla. 1983).

CONCLUSION

The Commission's fifty basis points reduction in Gulf's return on equity for mismanagement was a proper exercise of ratemaking discretion. Appellant has not shown that the Commission departed from the essential requirements of law and has not overcome the presumption of correctness which attaches to the Commission's orders. City of Tallahassee v. Mann, 411 So.2d 162 (Fla. 1981). Accordingly, the Commission's orders should be affirmed.

Respectfully submitted,

SUSAN F. CLARK
General Counsel
Fla. Bar No. 179580

DAVID E. SMITH
Director of Appeals
Fla. Bar No. 309011

FLORIDA PUBLIC SERVICE COMMISSION
101 East Gaines Street
Tallahassee, Florida 32399-0862
(904) 488-7464

Dated: March 14, 1991

CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing has been furnished this 14th day of March, 1991, by U.S. Mail to the following:

Jack Shreve
John Roger Howe
Office of Public Counsel
c/o The Florida Legislature
111 West Madison Street
Room 182
Tallahassee, Florida 32399-1400

G. Edison Holland, Jr.
Jeffrey A. Stone
Teresa E. Liles
Beggs & Lane
P.O. Box 12950
Pensacola, Florida 32576-2950

Alan C. Sundberg
Sylvia H. Walbolt
E. Kelly Bittick, Jr.
Carlton, Fields, Ward, Emmanuel, Smith & Cutler, P.A.
One Harbour Place
Post Office Box 3239
Tampa, Florida 33601

DAVID E. SMITH

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